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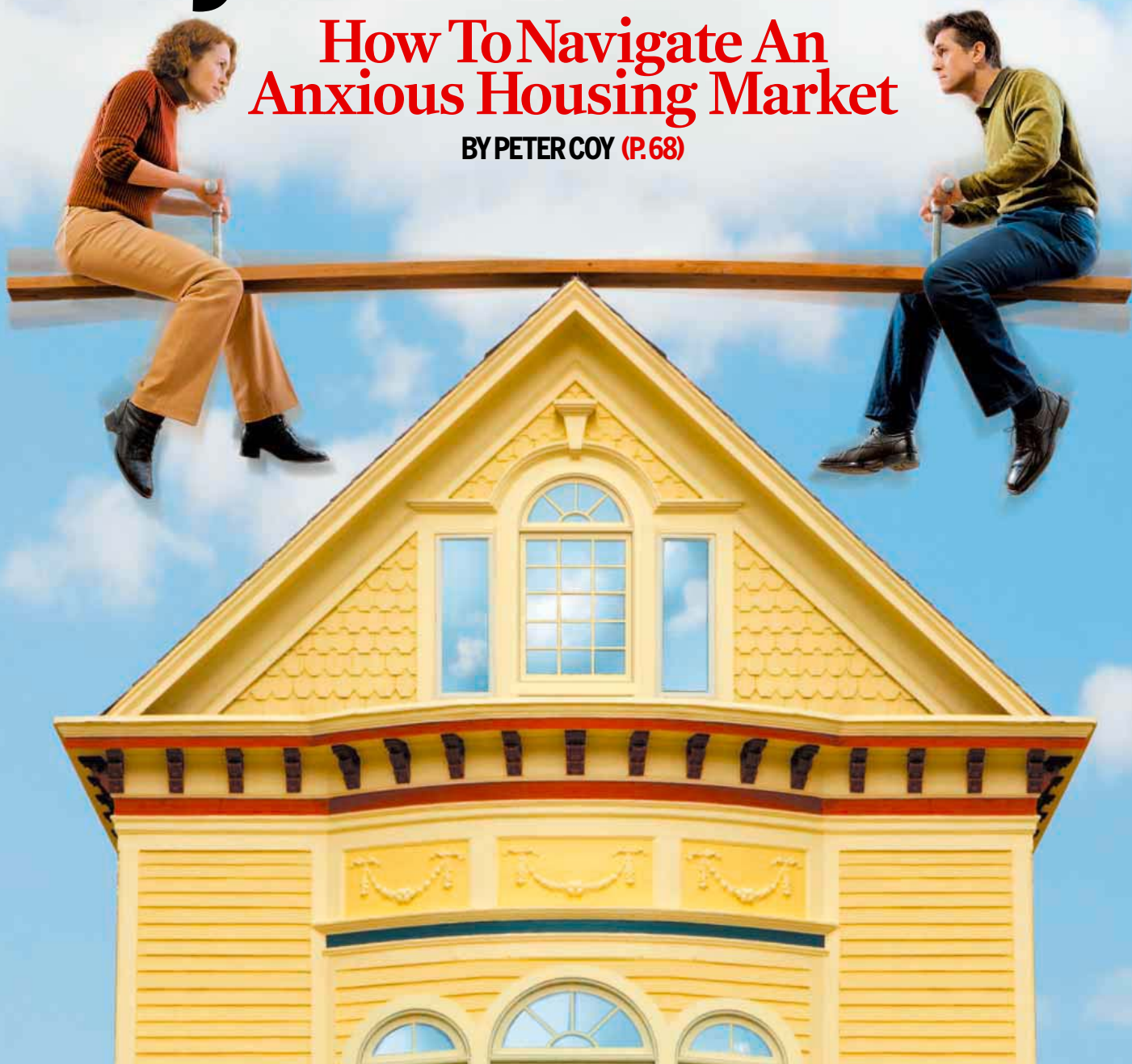
APRIL 10, 2006

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Buyer (and seller) Beware

**How To Navigate An
Anxious Housing Market**

BY PETER COY (P.68)





THERE ARE INFINITE DYNAMICS IN BUSINESS.

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Mastered.**

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New York City 311

High performance delivered for government.

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A full-page background image of Tiger Woods in mid-swing on a golf course. He is wearing a purple polo shirt, dark trousers, a black cap, and white gloves. A crowd of spectators is blurred in the background.

They're only obstacles
if you can't see
around them.

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Across U.S.-domiciled Large Growth funds, the Capital Growth Fund received 4 stars among 1,353 funds and 5 stars among 1,065 funds for the three- and five-year periods, respectively. Across U.S.-domiciled Mid Cap Value funds, the Mid Cap Disciplined Fund received 4 stars among 257 funds and 4 stars among 140 funds for the three- and five-year periods, respectively. Across U.S.-domiciled Small Cap Blend funds, the Small/Mid Cap Value Fund received 5 stars among 443 funds for the three-year period. Past performance is no guarantee of future results.

The Funds' advisor has voluntarily waived all or a portion of its management fees or assumed responsibility for other expenses, which reduces operating expenses and increases total return to shareholders. Without these reductions the Fund's returns would have been lower and ratings may have been lower. These reductions may be discontinued.

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A word about risk: Stock funds should only be considered for long-term goals as values fluctuate in response to the activities of individual companies and general market and economic conditions. Funds that invest in smaller companies involve additional risks because these companies often have limited financial resources, and their stocks tend to be more volatile and less liquid than those of larger companies. Each Fund's investment process may, at times, result in higher than average portfolio turnover and increased trading expenses, and may generate higher short-term capital gains. Investment strategies that emphasize particular market segments or fewer securities tend to increase the total risk of an investment (relative to the broader market). Each of these Funds is exposed to foreign investments risk. Consult each Fund's prospectus for additional information on these and other risks.

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V

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Earning it.
Investing it.
Spending it.



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show April 1 and 2:

ID Theft Worm: Bank or buy
on the Web? Learn how to
protect your personal financial
info from new real-time hackers.

Staging Homes for Sale: Quick
fixes to boost your property's
price in a softening market.

Investing in Metals: As gold
and silver trade near 20-year
highs, should you add some
luster to your portfolio?

Rock 'n' Roll Memorabilia:
We check out prized possessions,
commanding a pretty penny.

BusinessWeek weekend

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What's Hot This Week At BusinessWeek.com

Updated every business day. *BusinessWeek* magazine is available online free to subscribers: Go to www.businessweek.com and follow instructions to register.



Zooming into the Future

Our online special report, **Cutting Edge Cars**, features a collection of vehicles that push the limits of design, speed, and technology. If you think Swedish autos are staid and serious, not fast and furious, read about the **Koenigsegg CCX**, a performance car that has been clocked at speeds of up to 245 mph. You're not likely to see one on the road or in a showroom, but you can virtually kick the tires in the accompanying slide show. No carmaker can be considered up-to-date without a

big push into hybrid engines. Our report takes a look at French auto maker

Peugeot's efforts to develop **super-efficient hybrids** using a diesel engine rather than a gasoline-powered one. The company, which previewed the Peugeot 307 and Citroen 4 at the recent Geneva Auto Show, plans to have these 82-mpg cars for sale by 2010. If you really want to be on the cutting edge, how about a car that soars over traffic jams? **Flying cars** have been a dream for 90 years, and our slide show looks at some of the failed attempts, as well as current designs that may be on the market soon. For these features and more see our special report at www.businessweek.com/go/cutting_edge_cars06

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UP Front

“What you’ve got here is a quarterback with an out-of-date playbook.”

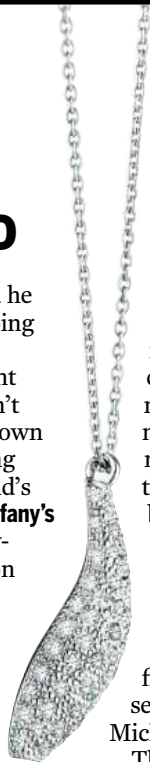
—Efficiency expert James P. Womack on General Motors CEO Rick Wagoner, who is under pressure to save the company and his job, as reported by The New York Times

EDITED BY
DEBORAH STEAD

BLING

GEHRY IS A GIRL'S BEST FRIEND

FRANK GEHRY once said he was “freaked out by going on the road and being marketed like Yves Saint Laurent,” but that didn’t stop America’s best-known architect from accepting one of the fashion world’s most exclusive gigs. **Tiffany’s** unveiled its new Gehry-designed jewelry line on Mar. 26 with a Beverly Hills blowout worthy of any Paris runway show. A-list attendees Owen Wilson, Quincy Jones, and Michael Eisner strolled the red carpet. Behind a wall, models wearing almost nothing but Gehry’s jewelry could be glimpsed through strategically placed peepholes.



Gehry worked with nine Tiffany designers for three years on the collection, which ranges from \$125 silver rings to a \$1 million diamond brooch shaped like the floor plan of his landmark Guggenheim museum in Bilbao. To design the jewelry, Gehry made sketches and manipulated metal models, a process akin to the way he designs buildings.

Tiffany hasn’t used an outside designer since it launched its Paloma Picasso line 26 years ago. “We just couldn’t find anyone that made sense,” explains CEO Michael Kowalski.

The line rolls out over the coming months at Tiffany stores in New York, Tokyo, and London. Expect Gehry to hit the road and help promote it.

—Christopher Palmeri

THE BIG PIC

JOBS AMERICANS WON'T DO? After farming (24%) and custodial jobs (17%), **construction is the U.S. sector with the biggest percentage (14%) of illegal immigrants.** Construction jobs with the highest concentration include...

Occupation	Illegals
Insulation workers	36%
Roofers	29
Drywall installers, ceiling tile installers, and tapers	28

Data: Pew Hispanic Center



MOST LIKELY TO SUCCEED
Moskovitz and Zuckerberg

WHEELER DEALERS

Omigod, That Site is Totally Hot

FACEBOOK, the Web site where students around the world socialize and network, has been creating a fair share of gossip on its own these days. The company has been in informal talks with **Viacom** about possible deals that could have valued **Facebook** at up to \$750 million. **Viacom**, owner of the **MTV**, **VH1**, and **Comedy Central** cable networks, declined to comment. CEO Mark Zuckerberg started Facebook in 2004 with Harvard classmates Chris Hughes and Dustin Moskovitz. The site is now the seventh most heavily trafficked on the Internet.

According to one investment banker active in technology deals, Facebook’s owners would want \$1 billion in a merger. A senior media executive puts the pricetag at \$2 billion.

Those are controversial valuations. “Facebook won’t get \$2 billion or \$750 million,” argues Rafat Ali, editor of **PaidContent**, an online digital media journal. But **Netscape** founder Marc Andreessen says that he “wouldn’t be surprised” by a big payday for Facebook’s founders. After all, he says, the company is on a growth tear at a time when traditional media outlets are losing steam, and top-tier Net properties are in high demand and short supply.

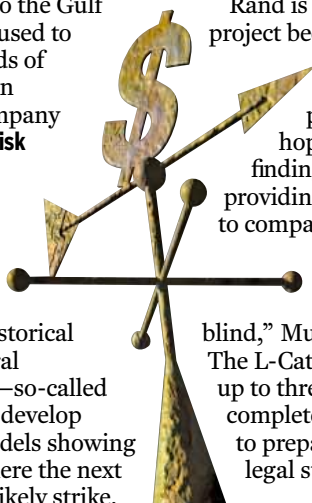
—Steve Rosenbush

(CLOCKWISE FROM TOP LEFT) RICHARD PIERCE; THOMAS BROENING; ARTHUR S. AUBRY/GETTY IMAGES

FORECASTS

IS THAT A LAWSUIT BLOWING IN?

ARE CLASS ACTIONS like hurricanes? Researchers are looking into whether techniques used to predict the risk of a big storm slamming into the Gulf Coast can be used to assess the odds of mass litigation striking a company or industry. **Risk Management Solutions**, a private risk-modeling firm based in Newark, Calif., uses historical data on natural catastrophes—so-called Nat-Cats—to develop computer models showing when and where the next disaster will likely strike.



Now social scientists at think tank **Rand** are teaming with RMS to see if data drawn from court files and insurance records can help predict “L-Cats,” or liability catastrophes. Robert Muir-Wood, chief research officer at RMS, defines an L-Cat as something that results in a financial exposure above \$100 million.

Rand is interested in the project because big lawsuits tend to have an impact on public policy. RMS hopes to sell its findings to insurers providing liability coverage to companies. “In the past, these policies have been written fairly blind,” Muir-Wood explains. The L-Cat project will take up to three years to complete—in time, maybe, to prepare for the next legal storm.

—Michael Orey



EX LIBRIS

JAPANESE COMICS meet the World Bank in *1 World Manga*, a graphic-novel series the bank commissioned to teach youth about global ills like poverty and AIDS. The novels, created by VIZ Media of San Francisco, feature Rei, a 15-year-old street kid. In the first of six planned books, he urges a woman to join a cooperative after a drought wipes out her yam crop. Despite dialogue like “That foreign company promises to give us fair trade payment,” the comics entertain. Jeff Yang, who analyzes Asian trends for consumer-research firm Iconoculture, says they’ll attract the many kids reading *manga* who increasingly see themselves as global citizens.

—Elizabeth Woyke

BLOGSPOTTING NAME THAT TUNE

bigpicture.typepad.com

» **WHY READ IT** For an overview of macroeconomic trends, leavened by the pop-culture musings of market strategist Barry Ritholtz.

» **NOTABLE POST** “Lately, I have been noticing that many economists, analysts, and strategists have been having some sly fun by naming their research after songs. My own contributions...have been the past two commentaries: Bad Moon Arising and Been Down So Long (It Looks Like Up to Me)...I also noticed [analyst] John Roque’s past two comments were titled BRIC House and R-E-S-P-E-C-T. And Morgan Stanley asked: Will the Real Slim Saving Rate Please Stand Up?”

DRAWN & QUARTERED



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MIGHTY SALES FOR MINI SNACKS

Betting that snackaholics prefer fixed-portion control to self-restraint, the food industry is selling more of America's guilty pleasures in 100-calorie packs. Just a few weeks ago, PepsiCo's Frito-Lay announced its 100-calorie line—Mini Bites bags of Doritos, Fritos, and other chips to be rolled out nationally over the next year. It joins, among others, Campbell Soup's Pepperidge Farm, which offers 100-calorie pouches of its Goldfish, and Kraft Foods' Nabisco, which in 2004 brought out 100-calorie packs of Oreo crisps, Wheat Thins, and Chips Ahoy! cookies, a lineup with \$100 million in sales in its first year.

Frito-Lay's entries bring the number of 100-calorie snack products to 33, up from 9 in 2003, says Tom Vierhile, director of Datamonitor's Productscan Online. Why 100 calories? "It's a nice round number" that delivers "the calorie punch" needed to give a sensation of being full, Vierhile says. If it doesn't, you can always tear open another pack. —Jessi Hempel

NOSH!

CAPITOL HILL FASHION'S BID TO KNOCK OUT KNOCKOFFS

MASS MARKET retailers have always carried inexpensive versions of the designer fashions their customers have glimpsed on the red carpet or the runway. That's because clothing is considered a "useful article" under American copyright law, not something whose design is to be protected as intellectual property.

But that distinction may be on its way out. The Council of Fashion Designers of America (CFDA), a nonprofit trade group, is lobbying for legislation that would extend copyright protection to fashion designs. Under the proposed bill, designers would submit sketches and photos to the U.S. Copyright Office within three months of their design's "publication"—its first public appearance on a catwalk, for example. Designs would be protected for three years. Suspected "plagiarists" could be sued. Other industrialized



countries, such as Japan and European Union members, already recognize fashion copyright. (France's legal system has protected garment designs since 1793.) "This law will make it reciprocal, by giving all designers protection over their work in this country," says Alain Coblenz, the attorney representing both the CFDA and two other sponsors of the bill, the **French Federation of Haute Couture, Ready to Wear & Designers** and the **National Chamber for Italian Fashion**.

To make its case on Capitol Hill, the CFDA hired **Liz Robbins**, a lobbyist who has taken on intellectual property issues for the music industry. And CFDA members such as couture designer **Zac Posen** have visited members of Congress to talk up the bill. Coblenz says that when designers have shown lawmakers their fashions alongside the knockoffs, "it becomes spectacularly clear" why these imitations are a form of flattery they can live without.

—Elizabeth Woyke

SCREEN TESTS

SILICON Valley hot shots are becoming Hollywood big shots. A few Web moguls and the recent film releases they've backed:



JEFF SKOLL
(former president, eBay)

FILM: *Syriana*. A politically charged thriller about intrigue in the global oil industry. One of about a dozen films financed by Skoll. Budget: \$50 million.



MAX LEVCHIN (above) PETER THIEL, AND ELON MUSK
(co-founders, PayPal)

FILM: *Thank You for Smoking*. A satire that follows a fictional Big Tobacco lobbyist as he makes his rounds. Budget: \$7 million.



SERGEY BRIN (left) AND LARRY PAGE
(co-founders, Google)

FILM: *Broken Arrows*. The story of a man who turns professional killer after his pregnant wife dies in a terrorist attack. In production. Est. budget: \$1 million.

(CLOCKWISE FROM TOP LEFT) DAVID RUDES/BW; NICK POULIS/POLARIS; MATTHEW STAYER/BLOOMBERG NEWS; MARK COSTANTINI/SAN FRANCISCO CHRONICLE; FREDERICK M. BROWN/GETTY IMAGES

Data: BusinessWeek, IMDb

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Boomers are going to follow their emotions with their pocketbooks. Where can I buy the stock?"

—Stephen D. Carter
Snellville, Ga.



A SLEW OF ANGLES ON ANTI-AGING

"SELLING THE PROMISE of youth" (Cover Story, Mar. 20) ignored the important achievements in anti-aging of the U.S. biogerontological community in recent decades. Several prominent biogerontologists believe that if adequate funding were available, human longevity could be extended anywhere from 10 to 20 years of vibrant life, free of aging-related diseases like cancer and cardiac illnesses, in the next 10 years.

However, the National Institute on Aging is starving for money for longevity research. Its total budget is about \$1 billion, but longevity research receives only \$20 million to \$50 million—most of the money goes to aging-related diseases. The principal reason is that Congress worries about the impact of extended human longevity on Social Security. Yet according to the March, 2005, report by the Trustees of Social Security & Medicare, the cost of Medicare will reach 6% of gross domestic product in 2024, exceeding that of Social Security. In 2025 it will amount to \$1.3 trillion and in 2080, \$14.75 trillion (in 2004 dollars)—more than twice as high as the cost of Social Se-

cure. Extending human longevity, free of aging-related diseases, could significantly cut the cost of Medicare, though it would increase the cost of Social Security.

—Victor Basiuk
Vienna, Va.

BOOMERS ARE GOING to follow their emotions with their pocketbooks. Where can I buy the stock?

—Stephen D. Carter
Snellville, Ga.

PHARMACY COMPOUNDING allows physicians to prescribe individualized treatments, including bioidentical hormones, to meet their patients' unique needs—needs that are unmet by manufactured, one-size-fits-all products. State boards of pharmacy regulate the preparation of bioidentical hormones, and their ingredients are regulated nationally. In 2002 the U.S. Supreme Court upheld the First Amendment right of compounding pharmacists to market their preparations or medications. Still, pharmaceutical giants like Wyeth falsely argue—and stories like this one misleadingly report—that the growth in the number of physicians and their female patients choosing bioidenti-

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cal hormones over manufactured ones is evidence of illegal mass marketing.

Sales of Wyeth's hormone products are down significantly since a study linked them to increased risk of heart attack and stroke. And while women and their physicians appear to be searching for options, Wyeth is lobbying the Food & Drug Administration to protect its pocketbook.

This is not the first time Wyeth has done so. About 10 years ago the company successfully lobbied to keep a generic version of Premarin off the market. It would be a shame if Wyeth got away with this again.

—L.D. King
Executive Director
International Academy of
Compounding Pharmacists
Sugar Land, Tex.

AS THERE IS NO “scientific proof that these regimens actually slow down or reverse the aging process,” I can only think that these are simply placebo pills for the people who take them.

—Alexandra Martin
San Diego

THE EARLY DAYS OF PHONE SERVICE VS. THE DO-IT-YOURSELF WEB

RE “WHY THE WEB is hitting a wall” (Information Technology, Mar. 20): Imagine what would have happened when telephone service was evolving if consumers had to choose from a dizzying array of options, buy and install their own expensive equipment, fix it themselves if it broke, and worry about their conversations being monitored by criminals. I suspect that a large percentage of households would have opted not to have phone service. No wonder the Web is hitting a wall.

—James J. Higgins
Manhattan, Kan.

HOW TO HIRE THE CANDIDATES LEAST LIKELY TO SUCCEED

“NET MOVIE MOGUL” (Voices of Innovation, Mar. 20) illustrated a disturbing and widespread problem with corporate hiring practices: Mika Salmi possesses proven drive, ambition, persistence, and the ability to recognize opportunity. Yet 125 companies rejected him outright.

Many companies today use software to screen résumés based on keywords and rely mostly on human resources clerks with little or no true business experience to review selected résumés. How can they recognize the traits shown by Mika and people like him? Steve Jobs, Bill Gates, and Mark Cuban would have been rejected by HR departments at many companies. Ca-

CORRECTIONS & CLARIFICATIONS

In “The BusinessWeek 50” (Cover Story, Apr. 3), No. 49 Hartford Financial Services Group Inc. is based in Connecticut, not Maryland.

“The whole truth about options” (Up Front, Apr. 3) misstated that Bank of America Corp. listed dollar values for executive stock options for the first time in its 2006 annual proxy. While dollar estimates were newly listed as part of “total compensation” this year, they appear elsewhere in previous company proxies.

“Background checks that never end” (News: Analysis & Commentary, Mar. 20) should have said that John Sculley was ex-president and CEO of Pepsi-Cola Co., not parent PepsiCo Inc.

“Rewiring Chuck Prince” (Finance, Feb. 20) should have specified that Citigroup continues to do shipping finance but that it no longer has a separate shipping finance division. Also, in response to a question at a conference about whether Prince would consider dilutive transactions, he said: “The word never is a big word...but in the practicalities of what all of us have to deal with, the chances of that happening are virtually nil.”

reer ads for these companies need to carry the disclaimer: “Achievers and mavericks need not apply.”

—George Muenz
Vancouver, B.C.

PRICING HANDMADE RUGS IS MORE COMPLICATED THAN IT SEEMS

HANDMADE RUGS ARE continuously portrayed as unworthy of a fair profit margin for the companies that make them (“My magic carpet ride in India,” Personal Business, Mar. 20). As a retailer, appraiser, and wholesaler, I have never seen a consumer come back from a source country having purchased a carpet at a “fair price” or even one that was mildly attractive—just an expensive souvenir complete with a story sometimes so ridiculous the teller only realizes it when he or she steps off the plane and repeats it.

Obeetee, the largest producer and seller of Indian carpets in the world, has produced rugs for the U.S. market for nearly 60 years, supplying many of the national brands U.S. consumers readily associate with quality, value, and taste. Your story insinuates that Obeetee pays commissions to hotels for referrals and that our carpets are dramatically overpriced—neither is true. “Rug rules...and resources,” the

rudimentary summation of how to buy a carpet, lacks substance and cites an “insider’s guide” that is nearly 30 years old.

Please, no more articles on handmade carpets unless you intend to evaluate the content, source, and references with the same standards you would any other industry. We work in a vibrant business with creative, hardworking people making products that can last for more than 100 years. It is a shame that outdated and misleading perceptions can last just as long.

—Bill Ward, CEO
Obeetee Inc.
New York

PAY FOR PERFORMANCE HAS LONG SINCE BEEN POOH-POOHED

RE JENA McGregor’s review of *Hard Facts, Dangerous Half-Truths & Total Nonsense*, by Jeffrey Pfeffer and Robert I. Sutton (“Forget going with your gut,” Books, Mar. 20): Who would have thought pay for performance might be flawed—O.K., besides W. Edwards Deming and Peter Scholtes, who have been saying it for decades?

Those of you who swear by pay for performance, please find a controlled study (a.k.a., facts) that supports your position. If pay for performance works and you’d like to improve your workers’ performance, why not give them all a 10% raise?

—Preston Black
Cincinnati

DOES THE U.S. SENATE VALUE DECORUM ABOVE ALL ELSE?

THE OBSERVANCE OF the U.S. Senate’s ancient rules of decorum apparently is more fitting than accomplishing its work (“Spittoons and quills but no laptops, please,” Washington Outlook, Mar. 13).

—Russell R. Griffin
Saint Cloud, Fla.

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Technology&You

BY STEPHEN H. WILDSTROM

Must-Haves for Digital DJs

Like many folks who have plunged into digital music, I have a large collection—nearly 30 gigabytes—stored on a hard drive, and I treasure the freedom to dip into it wherever I choose. So I was eager to try two new products, the Roku SoundBridge Radio and the Apple iPod Hi-Fi, that offer relatively inexpensive ways to enjoy digital music with high-quality sound.

The \$400 SoundBridge Radio looks a bit like an oversize version of those big clock radios you find in hotel rooms. And like them, it can play music to put you to sleep as well as to wake you up. But in addition to AM and FM broadcasts, a SoundBridge connected to a Wi-Fi wireless network plays Internet radio stations—Web sites that stream programming—as well as any music stored on a Windows PC or a Mac on the network.

The beauty of the SoundBridge is that it looks and feels a lot like a radio, even when it's playing tunes from your own collection. Nearly 100 Internet stations are preloaded, and they can be selected either by presets or by scrolling through a list on the big, bright display. The SoundBridge also searches your network for iTunes or other music collections, such as Musicmatch or Rhapsody. Choose a collection, then select the song, artist, album, or playlist that you want to hear, using either a remote or buttons on the SoundBridge. Getting this to work the first time may require changing some security settings, for which Roku provides clear instructions. The SoundBridge will play purchased or subscription music protected by Microsoft's PlaysForSure but not songs bought from the iTunes Music Store because Apple doesn't allow use of its copy-protection technology.

ROKU KEPT THE SOUNDBRIDGE SIMPLE by having you use a computer to do any complicated administration, especially anything that involves entering data. For example, you add more Internet stations by typing in their addresses on a Web page you can access from a computer on your network. But in one important respect, the SoundBridge is too simple. It supports only Wi-Fi's outdated Wired Equivalent Privacy security scheme, not the much stronger Wi-Fi Protected Access, and this requires you to use weak security on your entire network. Roku promises to fix the flaw.



ICANDY Apple's own Hi-Fi (above) and the Roku SoundBridge Radio



Of course, none of this means much unless the player provides solid audio, and the SoundBridge delivers. Its two speakers and subwoofer are a good size. It's true that the volume won't rattle your windows, and for the best stereo effect, one might wish to separate the speakers by more than the 11-in. width of the radio. Still, the sound is just fine for a bedroom, study, or cozy kitchen.

Apple has also moved up to true high fidelity, exhibiting its usual flair. The iPod brought simplicity to digital music, and products don't come any simpler than the \$349 iPod Hi-Fi. It's a big box, 17 in. wide and about 7 in. tall and deep. It has no buttons, not even a power switch. Plug it in and set any iPod made in the last couple of years (except the Shuffle) into a slot on the top.

Playing music through the Hi-Fi's speakers is just like listening to an iPod through earphones. A tiny remote is included—the same one used with Apple's new Macs—but all it does is control volume and let you move to the next or previous song in your playlist. (Sorry, no way to access the full menu from your couch.) The Hi-Fi has the best sound quality of any iPod speaker unit, including the popular \$300 Bose SoundDock. In fact, one ironic drawback is that the Hi-Fi will show up flaws in your music that you would miss with cheap ear buds.

These products share a refreshing simplicity. Like good consumer appliances, they don't try to do too much, and the things they focus on they do well, with a minimum of fuss. If only the PC industry would take this approach to heart. ■

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(TOP) PHOTOGRAPH BY ETHAN HILL

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Hide-and-Go-Seek an Ad

The ad world is filled with slick, ultrastylish characters. Kevin Slavin is not one of them. Today, Slavin, the managing director of a company called area/code, is wearing a rumpled button-down shirt and battered brown sneaker-shoes. His glasses are strictly functional. His hair is not artfully mussed. He sits in a featureless conference room in Manhattan, straining

to be heard over truly violent-sounding construction on the street below. When the 36-year-old self-described “game freak” says he disconnected his DirectTV because “it was cutting into my Xbox time,” you believe him.

Slavin’s endless enthusiasm for games encompasses even chestnuts such as capture-the-flag, and somehow he has managed to extrapolate a business from this obsession. Area/code, which Slavin co-founded with veteran game designer Frank Lantz, creates complex, ad-sponsored, multiplayer games that use a city’s physical landscape as a playing board—“urban games” or “big games” in gamer parlance. Lantz and Slavin thus outline scenarios in which advertising is not just tolerated but welcomed.

TODAY’S BIG GAMES go beyond Civil War reenactments. Players can be joined through the connective tissue of cell phones and Wi-Fi, which provide instant communication among players dispersed across large geographic areas and allow a game to be tracked in real time on the Web. This was the technological fairy dust sprinkled over Lantz’ Pac Manhattan, in which a reenactment of the ’80s video game classic was played out over several square city blocks in 2004. Popular games cast long shadows, and Pac Man remains a prominent cultural touchstone, which is one reason why Pac Manhattan won so much notice. The attention caused a light bulb to go on for Slavin, then working at an ad agency. “I was thinking,” he recalls, “this is media. This is a form of media we don’t yet know how to articulate.” The new form can crank up the kilowattage of marketing efforts, he says, by providing “actual experiences for people instead of telling them about something” and making those experiences public and visible to others. (This inverts the standard ad model, that aims at individuals and often celebrates private sensations: Our



APRIL, 2004
Pac Manhattan players in Greenwich Village

product will make you feel this way.)

Lantz and Slavin later collaborated on ConQwest for Qwest Communications cell phones, which in 2004 and 2005 unleashed teams across 10 cities in search of a coded image to be photographed with camera phones. That image appeared randomly in those cityscapes and when photographed yielded clues and riddles. It also appeared in weekly papers and fake ads in public spaces. (The mock ads were top-drawer, deadpan parodies with taglines such as “it smells so good you’ll fall in love with yourself.”) ConQwest cost only \$3.2 million, yet the novel campaign by a second-tier cellular player had a wide effect similar to Pac Manhattan’s. Press mentions were many and glowing, and industry awards followed.

Area/code’s vision borrows from others. It partly echoes dodgeball.com, a real-time mobile social networking system in which users trade their whereabouts while out and about. It also recalls the short-lived “flash mob” trendlet in which groups of strangers quickly gathered, performed a predetermined activity, and dispersed from random urban meeting grounds. Like a skateboarder, area/code sees unusual possibilities for play in a city’s street-level architecture.

It helps that area/code is more game-centric than marketing-centric. “They invest in an experience in its own right, which happens to communicate” a marketing message, says Matt Jones, senior design manager for user experience at client Nokia. That experience is both next-generation and traditional, by tapping into half-forgotten moments of childhood spent wholly caught up in the flow of a game. If advertising seeks to make us all hungry children, at least area/code gives us a playground and throws the doors open for recess. ■





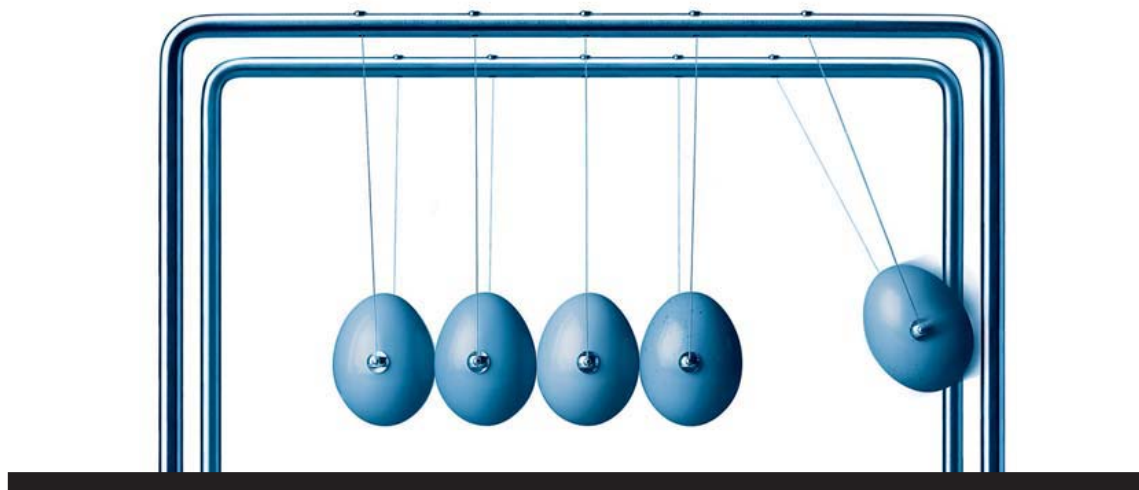
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BY JAMES C. COOPER

From Here On Out, The Fed Is Winging It

More uncertainty over future rate decisions will mean bumpier markets

U.S. ECONOMY

The Federal Reserve's first policy decision under new chairman Ben S. Bernanke was, as expected, a no-brainer. The Fed lifted its target interest rate on Mar. 28 by a quarter-point for the 15th time in the past 15 meetings, to 4.75%. The post-meeting statement included a bit more detail on economic activity, but the key

policy-related remarks were carbon copies of the Jan. 31 missive. In all, it was an obvious display of the greater transparency and continuity that Bernanke has promised.

Now it gets interesting—for both the markets and policymakers. Up to this point, judging Fed policy has been easy. Back in June, 2004, the Fed essentially told the markets it was going to lift its target rate from a 46-year low of 1% that was highly stimulative to economic growth to a more neutral level historically consistent with healthy growth and low inflation. Until now, the patterns in the economic data played only a small role in the Fed's game plan. That phase is over.

There is no more road map for the markets to follow. Policymakers' Job 1 is to decide whether the current target rate of 4.75% is high enough to assure that inflation will stay under control in the coming year. Not only do the markets not know what the Fed's next move will be, the Fed itself doesn't know. That means much more uncertainty surrounding future Fed actions, and more uncertainty means greater volatility.

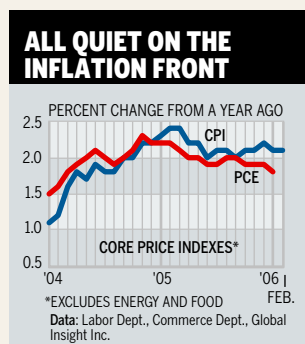
Market reaction immediately following the Fed's Mar. 28 hike is a case in point. Stock and bond prices sank over disappointment that the Fed did not hint that the end of its tightening cycle was near. On the contrary: The Fed repeated its Jan. 31 language, saying that "some further policy firming may be needed." The Dow Jones industrial average suffered a 110-point turnaround after the news, and 10-year Treasury yields, which had begun the day at 4.71%, finished at a 22-month high of 4.78%. More days like that appear to be in store as the Fed gropes its way toward the right policy.

HOW WILL THE FED KNOW when its work is done? The basis for that decision now shifts almost exclusively to the economic data. The next action or inaction will depend on how the policymakers interpret what each new squiggle in the charts means for the trends in economic growth and inflation. The upshot: Each economic report will take on increased significance for the markets, especially for bonds, over the balance of the year. Data surprises, particularly any that suggest stronger growth and more inflation, may pack more of a punch than they have up to now.

What signposts will the Fed be looking at? Of course, policymakers will say they consider everything. But three broad classes of data will probably command the Fed's attention. Readings on core inflation, which exclude energy and food, will show whether higher energy costs are working their way into the prices of other items. Labor-market data will indicate whether wage and salary

increases are outstripping productivity gains. And housing activity will be a key bellwether, given its past importance to overall growth and consumer spending.

Right now all three are sending fairly positive signals to the markets, suggesting the Fed might need only one more hike, to 5%, at its May 10



meeting. Policymakers undoubtedly take great comfort in how the price indexes are behaving. Despite the two-year runup in energy prices, current core inflation readings at the consumer level show not the slightest hint that costlier energy is pushing up other prices. The core consumer price index (CPI) in February stood only 2.1% ahead of its year-ago level, and the Fed's preferred inflation gauge, the core index for personal consumption expenditures (PCE), is slightly below 2% and has been edging lower (chart).

In coming months, any higher-than-expected readings in the price indexes hold the greatest potential to rattle the markets, for two reasons. One, they would suggest that the Fed is lagging in its efforts to control inflation. And two, current inflation rates tend to influence people's expectations of future inflation, which can feed back into pricing behavior and become a vicious cycle.

BUT EVEN IF THE PRICE INDEXES remain tame, the Fed will also keep a keen eye on the strength of the economy. Labor markets are stretched thin, and the ability of industrial and service companies to meet

demand is being tested. If the economy does not give convincing signs of cooling off in a way that will relieve these pressures, the Fed may feel the need to push its target rate north of 5%.

Perhaps the most difficult task for the Fed this year will be correctly interpreting the interplay between improving labor markets and slower housing. Both will influence consumer spending, but in opposite ways. The view in the markets right now is that the housing slowdown will dampen consumer spending, as outlays for home-related goods wane and consumers stop using the equity in their homes as a source of income for spending.

The housing downdraft is clearly under way (page 68). In February sales of new homes were down 21% from their peak last July, while sales of existing homes are off 5% from their high point last June. Further weakness seems likely. The new-home and condominium markets, where activity has been especially frothy with high turnover, could take the biggest hits in terms of both building activity and prices. Inventories of unsold new homes in relation to recent sales rates have jumped to the highest level in ten years, suggesting a growing imbalance between supply and demand.

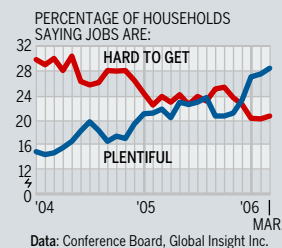
THE KEY QUESTION for future Fed decisions is this: How much will housing slow consumer spending? The answer will depend mainly on the health of the labor markets. The combination of improving income growth and past wealth gains, less than a third of which came from net home values last year, will help to

offset housing-related losses to spending power.

So far, businesses remain optimistic about both capital spending and hiring, and consumers are upbeat about the economy and job prospects (chart). The Conference Board's consumer confidence index in March rebounded from its February decline to the highest level in nearly

four years. Households reported feeling better about both present and future conditions, and their assessment of the current state of the labor markets was positive. Although the percentage of households describing jobs as "hard to get" edged up from February's 4½-year low, the proportion saying jobs were "plentiful" rose to

STRONGER JOB MARKETS ARE LIFTING CONFIDENCE



the highest level since August, 2001.

All this leaves the Fed with a tricky balancing act. The stronger the economy, the greater the need for rates to rise to assure that inflation stays down. But housing is keenly sensitive to interest rates, so overtightening could severely damage that crucial sector and possibly the overall economy. For the rest of the year, as policymakers sift through the data for clues on what to do next, investors would do well to prepare themselves for more bumpy days ahead. ■

INVENTORIES

The Cupboard Is Still Too Bare

AS DEMAND FOR manufactured goods has picked up, producers have yet to adjust their inventories accordingly. As a result, the decline in the inventory-to-sales ratio, a measure of the adequacy of stock levels, has accelerated in recent months. The trend is a favorable sign for increased factory activity.

In January overall business inventories were up just 4% from a year ago, the slowest pace in 19 months and far less than the 8.5% rise in shipments during the same period. February inventory levels of durable goods fell by 0.5%. This is a small part of business inventories, accounting for about 22% of the total, but it is an early indication

that February inventory growth may be continuing to slow.

The ratio of business inventories to sales is down to a historically low 1.24 months' supply. It is true that this ratio has been drifting lower for years as businesses have taken advantage of better technology to streamline production and supply chains. But since June, 2005, the ratio has been falling faster than the average rate of decline since 2000.

The inventory data are useful because they're "giving you a signal about whether demand is higher or lower than expected," says Goldman Sachs economist Andrew Tilton. The recent rundown in the ratio may be a sign that demand is stronger than manufacturers

expected. Indeed, the yearly percentage change in the inventory-to-sales ratio is a good leading indicator for the Institute for Supply Management's factory activity index, notes Tilton.

Economists see the ISM's March activity index rising further. Plus, the February factory survey showed that respondents continue to believe customer inventory levels remain too low. The ISM's index tracking inventory levels also show that manufacturers have let inventories decline during the past 11 months.

Manufacturers may also feel the need to bump up production to get inventories to more comfortable levels. While businesses are striving to keep supply chains lean, there is a limit. If inventories become too skimpy, businesses could face costly production disruptions—or even the possibility of lost sales. ■

—By James Mehring in New York

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The Business Week

News you need to know

EDITED BY HARRY MAURER



A Fracas over Immigration Seemingly overnight, the immigration debate has grabbed the center of the political stage, spotlighting a rift in the GOP that could prove perilous come November. **Senate Majority Leader Bill Frist** (R-Tenn.) hopes to win approval by Apr. 7 of legislation that would make it a felony to hire undocumented aliens. But the **Senate Judiciary Committee** on Mar. 27 endorsed a business-backed approach that would beef up border enforcement and create a guest-worker program while letting illegals already in the U.S. pay a fine and earn eventual citizenship.

Pulling against each other are two pillars of the governing coalition: Socially conservative blue-collar workers, the GOP's most dependable source of votes, and Big Business. Some strategists fear that the surprisingly large demonstrations across the country (Boston, above) herald an anti-Republican backlash among Hispanic voters.

See "Immigration reform: Why business could get burned," page 41

The Housing Puzzle Home-sale numbers have real estate mavens scratching their heads. On Mar. 23 the **National Association of Realtors** said sales of pre-owned homes jumped 5.2% in February over the previous month, with the median price up 10.6% over the year before. Not too shabby. Well, on Mar. 24 the **Commerce Dept.** said new-home sales collapsed by 10.5%, with inventories higher than they've been in 10 years. At least one economist, *BusinessWeek's* own **Michael Mandel**, has joined those expecting a painful bust.

See "Buyer (and seller) beware," page 68

Thunder from the Fed **Ben Bernanke** discovered newfound power when he drove the Dow down nearly 100 points on Mar. 28—through no fault of his own. Fed watchers were braced for the central bank's decision to raise its benchmark rate by a quarter-point, to 4.75%. But investors took it hard when Bernanke & Co. failed to signal more strongly that hikes had come to an end. The Fed left the impression that another boost in May is a sure thing.

See "From here on out, the Fed is winging it," page 25, and "Interest rates: What the markets missed," www.businessweek.com/go/tbw

Suspense in Detroit The **GM-Delphi-UAW** drama approached a showdown. Union reps turned up their noses at the latest offer from the bankrupt auto-parts maker, which could void its labor contracts on Mar. 31, possibly setting off a strike in the next month or two that would clobber GM. On Mar. 28 the carmaker laid off several hundred white-collar staffers and filed its annual report with the **SEC**, stating that accounting errors would force it to rejigger results for its financing arm, **GMAC**. It also said other complications might prevent it from selling GMAC for much-needed billions.

See "Twilight for the UAW," page 62

To the Barricades! France's center-right government is scrambling for a compromise after weeks of sometimes violent protest against a labor law that would make it easier to hire and fire young people. One option: **President Jacques Chirac** could delay the reforms, which would spare **Prime Minister Dominique de Villepin** loss of face.

Blue Bertelsmann For a company with a long history in the music biz, Bertelsmann's timing sure seems off. On Mar. 26, the *Financial Times* reported that the company wants to offload its music business, a 50% stake in **Sony BMG Music Entertainment**. That would mean selling at the bottom of the market—and just when digital music is starting to play a lucrative tune. A spokesman calls news of a sale "speculation," but privately held Bertelsmann may need the estimated \$2 billion in proceeds to help buy out its largest outside investor and fend off an unwanted IPO of its stake.

A Telecom Tie-Up? **Lucent** excels in wireless gear. France's **Alcatel** shines in broadband and fiber optics. Sounds like a good match—at least they think so. Alcatel's board was slated to discuss on Mar. 30 a \$33 billion merger that would create the world's No. 2 telecom-equipment maker and give Alcatel more clout in the U.S. One little problem: Lucent's **Bell Labs** does some secret military work. The unit could be spun off or placed behind a Chinese wall.

See "Lucent-Alcatel: A marriage of equals?" www.businessweek.com/go/tbw

S&P Anoints Google Finally, a hint of spring after Google's bleak winter. Between Jan. 11 and Mar. 22, the search behemoth's stock sagged 28%. But the next day, **Standard & Poor's** said it would add Google to its influential

S&P 500-stock index as of Mar. 31. (S&P is owned by *BusinessWeek* publisher **The McGraw-Hill Companies**.) By market close on Mar. 29, shares had jumped 16%, to \$395.

Schering's White Knight Germany's **Bayer** thinks it has a cure for the migraine caused by bitter competition and the disastrous recall of its cholesterol-busting **Baycol** in 2001. On Mar. 24 the pharma and chemicals conglomerate offered \$19.6 billion for Berlin-based Schering, trumping a hostile bid from German compatriot **Merck**. Schering, which makes drugs for birth control, cancer, and multiple sclerosis, will give Bayer's pharmaceutical biz more heft.

See "A pick-me-up for German pharma,"
www.businessweek.com/go/tbw

Pondering Patent Power Patent trolls get little sympathy—except from the **Supreme Court**. On Mar. 29 the justices lent what seemed to be a friendly ear to **MercExchange**, owner of rights to technology behind **eBay's** popular "buy it now" button. The case gets to the heart of debate over so-called trolls—companies that obtain patents only to license them. **Justice Antonin Scalia** pointed out to eBay that no one is allowed to take property from someone who doesn't want to part with it—even for a price.

See "EBay takes on the patent trolls,"
www.businessweek.com/go/tbw

Big Is O.K. After months of delay, **Whirlpool** won permission on Mar. 29 from the **Justice Dept.** to take over **Maytag**, its smaller, money-losing rival in white goods. Legal beagles had speculated that the \$1.7 billion merger could be nixed since it would cement Whirlpool's No. 1 spot. But Washington said Whirlpool is facing new competition from Asian outfits.

Exit of the Week

It's a shakeup of sorts: With his poll numbers at record lows, **President George W. Bush** began to shuffle the White House deck on Mar. 28 by replacing **Chief of Staff Andrew Card** with **Joshua Bolten**, head of the **White House Office of Management & Budget**. The move won't placate Republicans baying for new blood at the top, since Bolten, 51, is a longtime Bush adviser. Before joining the Bush team, he was **Goldman Sachs'** executive director for legal and government affairs in London. Card, 58, is the second longest-serving Chief of Staff in history, but his management skills came into question after the botched response to **Hurricane Katrina**, the ill-advised Supreme Court nomination of **Harriet Miers**, and the snake-bit **Dubai Ports** deal. While Bush denies rumors of a staff purge, senior Administration officials say Bolten will make any further changes he deems necessary. His OMB deputy, **Joel Kaplan**, appears to be the front-runner to become budget boss.

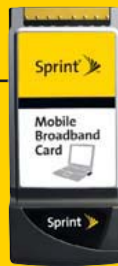


JOSHUA BOLTEN



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IPO WATCH

WHERE'S THE BEEF?

Burger King's upcoming IPO looks lucrative...for the private-equity firms doing the deal. While they make even more cash, the chain's long-term debt could hit \$1 billion. **BY DEAN FOUST**

ON A SUNNY SEPTEMBER day in 2004, Burger King Corp.'s new CEO, Gregory D. Brenneman, drove into the parking lot of the company's Miami headquarters dressed up as the fast-food chain's well-known mascot, the King. After a pep rally to congratulate the 700 assembled employees for their role in Burger King's nascent turnaround, Brenneman and other execs handed out burlap bags stamped with big dollar signs. The sacks were stuffed with bonus checks. And they were three times larger than the previous year's. It was a gesture that endeared the new boss to his troops.

Now Brenneman is trying to win over a much tougher crowd: Wall Street investors. Sometime this spring, Burger King's owners, a group of private-equity firms that includes Texas Pacific Group, Bain Capital Partners, and Goldman Sachs Funds, plan to raise up to \$600 million in an initial public offering. Assuming the IPO is successful, the private-equity guys will have nearly doubled their

original investment—while retaining a majority stake in Burger King. Not bad for about three years' work.

The coming Burger King IPO offers a window onto the clubby world of cash-rich private-equity players and how they make their billions. During the 1980s, firms such as Kohlberg Kravis Roberts & Co. and Blackstone Group LP borrowed heavily to buy companies, broke them up, and sold off the pieces at huge profits.

"LIPSTICK ON A PIG"

NOWADAYS PRIVATE-EQUITY firms often spend hundreds of millions of their own money on an acquisition (BW—Feb. 27). Just as often, though, they load up the companies with debt and use the money to pay themselves special dividends and other fees that allow them to profit even if the company itself struggles. Then the backers take the company public, often pocketing the lion's share of the offering.

That is basically how the Burger King saga is unfolding. For investors hoping to get in on the IPO, the question is whether the burger



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computer virus around

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for the Choctaw tribe?

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who's going organic



The average BK location generates half the revenue of a McDonald's



chain is really on the road to recovery. Critics argue that since an initial rebound in traffic after private-equity players bought the company from Diageo PLC, Burger King's sales growth again is starting to lag rivals.

And they contend that the company paints an overly rosy picture in press releases and its recent Securities & Exchange Commission filing, in part by changing the way sales are tracked to give the appearance that they are on a solid upswing. What's more, Burger King is far more indebted than rivals McDonald's Corp. and Wendy's International Inc. That limits the fast-food chain's ability to reinvest in new products and restaurants. "This is as close to putting lipstick on a pig as you get," says a prominent Wall Street analyst who asked not to be identified.

Both Burger King and Texas Pacific declined comment on these and other matters, citing the restrictions against companies talking during the "quiet period" imposed by the SEC before IPOs. But some analysts and investors believe Texas Pacific and its partners are rushing Burger King to market before it's ready.

It's no secret why they want to get this deal done. Recent restaurant IPOs such as Chipotle Mexican Grill Inc. and Wendy's spinoff of the Tim Hortons Inc. doughnut chain were scorched. And if there's any firm that knows when and how to buy and sell companies, it's Texas

Pacific. Founder David Bonderman, a former bankruptcy attorney, made his name managing the oil wealth of Fort Worth's well-known Bass family. In the 1990s, Texas Pacific scored big with investments in Continental Airlines, Seagate Technology, and Oxford Health Plans. The firm was so successful that when Bonderman turned 60, in 2002, he hired the Rolling Stones to perform at a private bash in Las Vegas.

By all accounts, Bonderman and his investing partners got a great deal for

Then this past February, Burger King borrowed an additional \$350 million so its owners could pay themselves and its two partners a special \$367 million dividend. In addition, Texas Pacific and the other investors are getting \$30 million more to end a contract in which they received \$9 million a year in management fees from Burger King.

Assuming the private-equity owners use part of the \$600 million raised in the IPO to pay down the \$350 million loan, that leaves as much as \$250 million. Add

that to the \$367 million dividend and the \$30 million kill fee, and their take totals \$647 million, nearly double their original investment. It's all good for the owners, but Burger King ends up with \$1 billion in long-term debt—or more than double the relative debt loads carried by rivals like McDonald's, Wendy's, and Yum! Brands. That leaves Burger King in junk territory.

This would be bad enough if the company was cooking up beefy profits and sales gains. But that isn't happening. Burger King's profit margin for the fiscal year ended last June was just 2.4%,

vs. the 5.9% earned by Wendy's and 12.7% at McDonald's in calendar year 2005. Meanwhile, the average BK restaurant still generates just a little more than half the sales of a typical McDonald's. "They've turned the train around," says Dennis Lombardi, executive vice-president at WD Partners, a Columbus (Ohio)-

LBOs to IPOs

Leveraged buyout firms are looking to flip big chunks of their investments to public investors. Here is a partial list of pending offerings:

COMPANY (PROPOSED TICKER)	BUSINESS	LEAD BUYOUT FIRM
J. CREW GROUP (JGC)	Apparel and accessories	Texas Pacific Group
GOODMAN GLOBAL (GGL)	Heating, ventilation, products	Apollo Management
MERRILL CORP. (MRLL)	Business services	DLJ Merchant Banking
PROGRESS RAIL SERVICES (not available)	Locomotive and rail-car maintenance	One Equity Partners
SEALY (ZZ)	Mattresses	Kohlberg Kravis Roberts

Data: IPOHome.com, company filings

Burger King in 2003. Diageo originally sought \$2.26 billion for the burger chain, but Bonderman and his LBO partners succeeded in knocking the price down to \$1.5 billion. What's more, analysts believe Texas Pacific, Bain, and Goldman kicked in just \$325 million of their own money, opting to borrow the rest.



Have It Whose Way?

Many private-equity firms, including Texas Pacific, follow the same playbook to extract big profits from the companies they acquire:

BORROW BIG-TIME Private-equity firms use heavy amounts of debt to minimize the cash they have to invest. For its \$1.5 billion acquisition of Burger King, Texas Pacific is believed to have invested just \$325 million of its own money, borrowing the rest.

PAY YOURSELF Private-equity firms aren't shy about pulling special dividends and fees out of their companies. Texas Pacific recently charged Burger King \$30 million to end its "management contract" and took out loans to pay itself and its partners a "special dividend" of \$367 million.

GO PUBLIC AGAIN Firms usually take the company public again within a few years, reaping large paydays. When Burger King goes public, Texas Pacific and its partners will have already nearly doubled their original investment. Not a bad result for about three years' work.

Data: SEC filings; BusinessWeek

based restaurant development firm. "But I'm not sure it's out of the tunnel."

To be fair, Brenneman, who helped get Continental Airlines airborne again during the 1990s, hasn't exactly been sitting around watching the grass grow. A hard-working son of Mennonites, who spent summers as a teen shoveling hay on his grandfather's Kansas wheat farm, Brenneman got busy the moment he became CEO in August, 2004. The goal was to go public by 2006, so Brenneman had little time to show results.

SKIMPY PROFITS

HE DOVE INTO the job, getting new products such as Chicken Fries, the Angus Steak Burger, and the Tendercrisp chicken sandwich out into restaurants. To boost morale and improve communication with the troops, Brenneman, 44, delivers folksy voice mails every Friday, updating employees and franchisees about the latest results and initiatives.

Helping franchisees earn more money was another priority, so he boosted group purchasing and commissioned the design of a smaller prototype store that is more than 25% cheaper to build. And to solidify Burger King's standing with highly coveted "superfans"—men aged 18 to 34—Brenneman rolled out a new male-oriented ad campaign that depicts the King mascot playing in NFL games.

The initiatives seemingly have paid off: After earning just \$5 million in the fiscal year ended June, 2004—Texas Pacific's first full year of ownership—Burger King reported profits of \$47 million in the following 12 months.

But for a company that raked in \$1.9 billion in revenues in its last fiscal year, that's a pretty skimpy return. And it's fair to ask whether Burger King achieved its

numbers by whacking advertising. According to TNS Media Intelligence, a New York media-tracking service, Burger King spent \$268.7 million on national advertising in 2005. That's \$54 million less than the year before and \$120 million less than in 2002, the last year Diageo owned the company, albeit with slightly more restaurants. Had Burger King spent what it did in 2004, its \$47 million profit would have been lower.

Brenneman & Co. also claim that sales at stores open more than one year—a common industry measure—have been rising steadily for seven straight quarters. But heads turned in restaurant industry circles when Burger King last year started reporting sales on a quarterly basis instead of monthly. Many chains, including McDonald's, report same-store sales every month. And some analysts wonder whether Burger King's switch was an attempt to mask a sales drop during some months. After a 6.7% rise in same-store sales during April, the last month that Burger King disclosed monthly numbers, the company reported second-quarter sales rose just 1.8%, suggesting that sales were negative in May or June.

It doesn't help matters that Burger King's relations with the chain's franchisees have been less than stellar. While some praise Brenneman for his efforts to boost sales, others complain that Texas Pacific hasn't done enough to help struggling operators get back on their feet. They and their lawyers say Burger King has pushed struggling franchisees who filed for bankruptcy protection to close their underperforming stores and go out of business.

Matters grew so acrimonious that, last October, the company severed ties with the National Franchise Association Inc.,

which represents the operators of about 6,000 Burger King restaurants. In a letter to the association, John W. Chidsey, Burger King's president and chief financial officer, blasted the group's leaders for failing to support plans to expand hours, promote a value menu, gift cards, and other initiatives.

OPPORTUNE TIMING

IN THE MONTHS SINCE, Burger King has tried to sideline the NFA by holding separate discussions with the franchisees it deems more cooperative. The company began talking to the NFA again in February. The group's new head, Joseph D. Anghelone, praises Brenneman and his team as being "very professional and dynamic," but he notes that Burger King is still in arrears on \$1.7 million in support payments owed to the association. Burger King in its prospectus says relations are improving.

In the end, the Burger King IPO will likely succeed. Given the heavy demand for the IPOs of Chipotle and Tim Hortons, some investors think Texas Pacific picked an opportune time to begin unwinding its stake in the fast-food chain. "I've learned to never bet against Texas Pacific," says Peter L. Goldman, a portfolio manager at Chicago Asset Management Co., which oversees \$750 million in investor funds. "They've created value in tough circumstances. Failing that, they've always succeeded in easing out of their mistakes."

But for investors, the question remains whether Burger King's owners have truly set the company on a sustainable path or are simply trying to pawn off a business with less beef than bun. ■

—With Brian Grow and Coleman Cowan in Atlanta, Michael Arndt in Chicago, and David Henry in New York

Corporate Cash: Use It or Lose It

These and other chronic hoarders might soon be targets of shareholder activists who want the money used to boost stock prices. Tech outfits lead the list

BY MARA DER HOVANESIAN

Corporate America is sitting on a huge pile of cash. The nonfinancial companies in the Standard & Poor's 500-stock index have amassed a record \$637 billion, according to S&P equity analyst Howard Silverblatt. They can deploy that money in numerous ways to the benefit of investors, whether it be acquisitions to improve their growth prospects, share buybacks to raise their earnings per share, or dividends to transfer value directly to shareholders.

But the sheer size of their hoard shows that they've been slow in putting the cash to work. Their biggest fear: making the wrong decisions with their money and raising the ire of shareholders.

They can't sit on the sidelines forever, though. At some point, say analysts, so-called activist hedge funds, which take big positions in companies and agitate for changes, will get involved. Already, hedge fund managers Carl Icahn and Kirk Kerkorian have taken on huge companies—General Motors Co. and Time Warner Inc., respectively. It's only a matter of time before the activists start flocking to the many money piles dotting Corporate America. "Low interest rates and hefty cash balances are an extremely powerful cocktail for shareholder activism," says Morgan Stanley's chief U.S. equity strategist, Henry McVey. "I'm not arguing that management should spend the money willy-nilly, but we're coming out of a multiyear funk where investors are waking up and saying, 'wait a minute, there's great growth [potential] out there.'"

The accompanying table shows the companies in the S&P 500 with the most cash on their books as a percentage of their total market value. Note the healthy dollop of technology companies on the list. Nicholas Colas, director of research at Rochdale Securities LLC and a former analyst at hedge fund SAC Capital Advisors LLC, explains that tech companies' cash balances are typically greater than those of the average S&P company by a factor of three. But while "there's a constant challenge to keep investing that cash intelligently," he says, "they've got to start doing something with that money." Before long, they may have no choice.

COMPANIES*	MARKET CAP AS OF 3/28/2006 (MILLIONS)	CASH AS OF MOST RECENT QUARTER (MILLIONS)	CASH AS A % OF MARKET CAP 3/28/2006
NOVELL	\$2,979	\$1,686	57%
COMVERSE TECHNOLOGY	4,747	2,325	49
SANMINA-SCI	2,267	1,039	46
LOUISIANA-PACIFIC	2,905	1,325	46
SOLECTRON	3,554	1,527	43
CMS ENERGY	2,883	1,045	36
INTERPUBLIC GROUP OF COS.	4,270	1,349	32
COMPUWARE	2,970	830	28
PMC-SIERRA	2,270	628	28
MOTOROLA	54,489	14,785	27
UNISYS	2,373	643	27
HASBRO	3,732	942	25
QLOGIC	3,073	719	23
KLA-TENCOR	9,617	2,227	23
ELECTRONIC DATA SYSTEMS	13,954	3,220	23
U.S. STEEL	6,676	1,479	22
LSI LOGIC	4,378	939	21
SEARS HOLDING	20,891	4,440	21
APPLIED MATERIALS	27,977	5,808	21
EASTMAN KODAK	8,257	1,665	20
ANALOG DEVICES	13,569	2,735	20
NOVELLUS SYSTEMS	3,229	649	20
GAP	15,766	3,042	19
TELLABS	7,170	1,371	19
BMC SOFTWARE	4,561	862	19

Data: Rochdale Securities LLC

*Companies in the S&P 500 with earnings growth and positive free cash flow. Excludes health-care and financial companies.



With 244 hp, leather seats and available navigation system, you'll be on the right track. The Accord EX V-6 Coupe.

honda.com 1-800-33-Honda 6-speed model shown. ©2005 American Honda Motor Co., Inc.





CONNECTIONS

VP Irving wants the Web to feel linked to the PC

ogy inside Windows still may take years to develop and update, but Microsoft is

committed to popping out pieces of software—such as its latest photo editing technology—as soon as they're ready. Photo editing upgrades would be automatically downloaded from the Web and could be connected to online photo-storage sites that could generate revenue. The other big shift is in how Microsoft gets paid. Online ads are its new obsession. The company's executives grew up in the world where they sell software by the box, a business that's growing slowly these days. While Microsoft has long relied on advertising to support its MSN Web portal, it's now selling ads more aggressively and in new ways. It has begun placing ads within the Live services. And it's experimenting with homegrown technology that lets users turn down certain types of ads but request more of others. Piper Jaffray Cos. analyst Safa Rashtchy estimates online advertising will top \$55 billion globally by 2010, which translates to 27% compounded annual growth.

There are plenty of unanswered questions about the Live strategy, however. Microsoft's ad technology is unproven. It trails both Google and Yahoo! in Web search, and that may keep advertisers from paying top dollar. What's more, the market for many of Microsoft's new services is untested. So far, the appeal appears limited to Web enthusiasts who write blogs and have multiple e-mail accounts. Rivals are adding mainstream applications such as word processors and spreadsheets, but analysts don't expect Microsoft to offer services that compete with its Office cash cow.

Still, Microsoft had to do something. It's under increasing pressure to keep its traditional PC software relevant even as it sprints into new online markets. Live is off to a solid start, even impressing some of the Web up-and-comers. "Microsoft is starting to get it," marvels Jeff Mellen, executive vice-president of startup YouOS, which just launched a Web site that

hosts an array of online services for people to tap into from their home computers or mobile devices. "It's intimidating for a company like ours, but, as somebody who likes technology, it's good to see."

—With Steve Hamm in New York

KEN LAMBERT/SEATTLE TIMES

ONLINE SERVICES

KEEPING UP WITH THE GOOGLES

Microsoft's next Windows version is hung up, but its cool Web services are flowing freely

BY JAY GREENE

THE DELAY OF MICROSOFT Corp.'s Windows Vista operating system until next year makes the software giant look like a dinosaur stuck in the tar, but that's not the whole picture. Its efforts to match the Googles of the world with fast online innovations seem to be paying off. In the five months since Microsoft announced its Windows Live strategy, it has released no fewer than 20 new services that are attracting millions of consumers. "They now gain some of that agility that Google has enjoyed," says analyst Van Baker of researcher Gartner Inc.

What exactly is Live? It's a set of technologies designed to blend the programs people run on their computers, such as Windows or e-mail, with the things they do out on the Web. Live.com, for instance, is a next-gen Web portal loaded with services such as Windows Live Expo, where people can search classified ads on the Web and compare notes on bargains with people on their instant messenger buddy

lists. Live "makes it feel like the Web isn't a place where you go to. It's linked [to desktop computing].... And it's very personal," says Microsoft Vice-President Blake Irving.

That combination of PC and Web services is already drawing regulatory scrutiny. European Union Competition Commissioner Neelie Kroes wrote to Microsoft Mar. 29, expressing concerns that Vista could limit consumer choice by giving Microsoft's own programs advantages over the alternatives. The letter raises the specter of an EU investigation prior to Vista's launch in Europe. Microsoft's reply: Consumers will continue to be able to choose whatever programs they like.

The Live strategy creates a new business model for Microsoft. For starters, the company is revamping its approach to software development. The core technol-

THE STAT

20

The number of new Microsoft online services since November

COMPUTER SECURITY

NASTY, BRUTISH, AND SNEAKY

Hackers have raised the stakes with a new bug almost immune to detection

BY BRIAN GROW

AS A DATA SECURITY specialist, Jeremy Pickett sees all kinds of digital tricks. So on Mar. 20, when he was tracing the origins of a computer worm that had been blocked the night before from entering a client's computer network, Pickett wasn't too surprised that it tried to connect with four sleazy Web sites, most of them, he believes, in Russia. Or that it then tried to load victims' PCs with as many as 30 new pieces of "malware," ranging from spam programs to those that automatically dial in to expensive phone-sex services.

But the real shock came when Pickett decided to test another bug by infecting his own PC with it. Out slithered a program that promptly installed itself deep inside his computer. There it became virtually immune to detection from the basic antivirus software that scans for dangerous code. The bug—known as a "Trojan," which in turn was hidden inside a "rootkit"—was designed to activate whenever a Web surfer typed in a user name or password for bank accounts or Web sites for dating, social networking, or e-mail. Pickett went to a bank site and entered fictitious log-in information. Right before his eyes, those data were sent streaming back to Russia, joining the IDs of thousands of real victims. His reaction: "absolute horror."

This nasty bit of code, appropriately named "the Hearse" by Pickett's employer, Sana Security Inc. in San Mateo, Calif., is threatening to raise the stakes in the spy-vs.-spy war over cybercrime. That's because the average computer security program sifts for known worms and viruses on PCs. But rootkits cloak data-stealing code so that it can hide in the deepest guts of Windows software without showing up in task lists as an active



What a Scam

The Hearse outbreak allowed thieves to steal user names, passwords, and bank accounts. The toll:

90,000

Pieces of personal data stolen

37,000

Online accounts compromised

6,500

Companies hit

Data: BusinessWeek

program. Criminals, having greatly expanded their knowledge of Windows' inner workings, are flocking to this new tool. Russian computer security company Kaspersky Lab estimates that on average 28 new rootkits emerged each month in 2005, up from six per month in 2004.

Only five of 24 antivirus outfits picked up the Hearse outbreak by Mar. 21, according to virus tracker VirusTotal.com. At first, antivirus giant Symantec Corp. was not among them, though it says it detected the bug the next day. In one of the first real-time cyber stakeouts, Sana mon-

itored one of the Russian Web sites for four days in late March. Ironically, it was left open to public view thanks to a security lapse by its unknown operators. Pickett watched as some 90,000 pieces of personal data from clients of more than 6,500 companies flowed across his screen. "It's like [Pickett] put on night vision goggles and watched," says John M. Frazzini, CEO of Secure Systems Corp. and former head of the Secret Service's Electronic Crimes Task Force in Washington. The show lasted until a Russian Web host, warned by Sana, took the site down on Mar. 24.

Equally alarming is the roster of victims, a cross-section of American business. Customer accounts for compa-

nies such as social networking site MySpace.com, auction site eBay Inc., credit-card and banking company Capital One Financial Corp., and Internet service provider AOL Inc. were compromised, *BusinessWeek* learned. Names and passwords from over 2,000 MySpace accounts were stolen. Spokeswoman Dani Dudeck says the company "takes user privacy and site security very seriously and quickly responds to all potential threats."

Many companies, though menaced anew every day, still don't have systems in place to react quickly to warnings. When Pickett and co-workers contacted some of them, they received automated e-mail responses or had to call multiple people. One unnamed company reported Sana officials to its nuisance department. Some moved faster. EBay quickly blocked compromised accounts until new passwords could be set. Bank of America Corp. officials immediately contacted the Secret Service's Criminal Investigative Div.

And the Hearse? Analysts suspect the hackers simply moved to a new, undetected collection spot. Warns Sana CEO John Zicker: "How deep does the rabbit hole go? Did we get there? No." ■

BusinessWeek **weekend** To learn how you can protect your financial info from hackers, watch BusinessWeek Weekend. Check your local TV listings or go to businessweekweekend.com



INSIDE STORIES

CASHING IN ON THE KATRINA CLEANUP

Why the Army is about to hand an Indian tribe an enormous no-bid contract

BY DAWN KOPECKI

THE MISSISSIPPI CHOCTAW Indians are looking for another way to work Washington—this time, through the Pentagon. You remember the Choctaws: The wealthy tribe got national notice last year as one of Jack Abramoff's biggest clients, paying the disgraced Republican lobbyist and his business partners more than \$27.6 million to sway lawmakers on gaming issues. In Abramoff's recent plea agreement, he admitted to bribing members of Congress by funneling millions from the Choctaws and other tribes through charities.

Now the Choctaws are poised to receive a \$300 million no-bid federal contract for post-Katrina cleanup in Mississippi. They are bereft of Abramoff's counsel: He was sentenced on Mar. 29 to nearly six years in prison and faces up to 30 more years for the charges involving the Choctaws. Yet the tribe has capitalized on contracting laws that favor Native Americans and on Congress' political pressure to steer Hurricane Katrina cleanup cash to home state companies. According to e-mails and doc-

uments reviewed by *BusinessWeek*, top Republicans led by Mississippi Senator Trent Lott have been leaning on the Army Corps of Engineers to replace AshBritt Inc., the big cleanup contractor based in Pompano Beach, Fla., with smaller home state firms.

The Corps thinks it has found the answer: IKBI Inc., the Choctaws' federal contracting subsidiary. A wrinkle in federal procurement rules designed to help Native Americans lets the Army forgo the usual competitive bidding process to award all \$300 million in work to the Choctaws as a sole-source contract.

The downside? The Choctaws' new contracting company has just seven employees and has never won a federal contract, according to the Small Business Administration. What's more, IKBI plans to subcontract much of the work to a large white-owned outfit in Tennessee.

Neither the Choctaws nor IKBI would comment for this story. The tribe is one of Mississippi's largest employers, operating casinos and other businesses, including a company that makes automotive wiring for Ford Motor Co. The Choctaws are the second-largest donor to federal campaigns among Indian tribes. But



IN BILOXI Cleanup profit margins could be as high as 25%

their direct gifts to Lott, \$27,000 since 1999, are relatively small.

Controversy has clouded the federal cleanup ever since Katrina and Rita landed their one-two punch on the Gulf Coast. Mississippi politicians were quick to criticize AshBritt, a company with ties to the Bush Administration and Mississippi Governor Haley Barbour's former lobbying firm, which won a \$500 million emergency job to remove debris in the state.

Mississippi lawmakers, led by Lott and Representative Charles W. Pickering Jr. (R-Miss.), urged federal agencies to steer money to in-state companies. Some 72% of AshBritt's subcontractors are based in Mississippi. But less than 6% of the prime contracts had gone to local firms.

Steering the prime contracts to in-state companies helps lawmakers in two ways. First, prime contractors make more money. "The difference in profit between the prime contractor and subcontractor is significant," said Brian Perry, spokesman for Pickering. Neither AshBritt nor the Corps would discuss the company's profits. But Pickering's staff estimates that AshBritt's profit margin could be as much as 25%—money that an in-state contractor could keep. Second, subcontracts don't reap the same attention as prime contracts.

The Corps began looking for ways to rebid AshBritt's contract soon after it was awarded in September. E-mails between the Pentagon and the Engineering Corps'

Anatomy of a Loophole

The Mississippi Choctaw tribe could land a sole-source contract worth up to \$300 million to clear debris from Hurricanes Katrina and Rita. Here's how:

THE LOOPHOLE Special breaks under the Small Disadvantaged Business (SDB) program for companies owned by tribes.

HOW IT WORKS Companies owned by Native American, Alaskan, or Hawaiian tribes can bid with no competition on designated federal contracts of any size. Other minority-owned SDB companies face tighter limits.

WHAT IT'S WORTH Tribal companies got \$1.8 billion of the \$19.5 billion in SDB contracts issued in 2003.

WHO WINS The Choctaws will get the contract, but most of the work will be subcontracted to a white-owned Tennessee company.



contracting office in Vicksburg, Miss., cited intense pressure from local lawmakers. Colonel Norbert Doyle, the Corps' top contracting official, noted in an Oct. 20 e-mail, "The [Mississippi] staffers raked us over the coals."

The Army decided to pursue an aggressive plan to cut out AshBritt and divert the remaining Mississippi cleanup money to local outfits. "The reason we are separating it out is because of the political pressure to get rid of the 'big' out-of-state contractors and award contracts to smaller firms," a top procurement officer told Doyle in an e-mail dated Oct. 25.

The Corps dusted off a little-used law called the Stafford Act to prohibit

out-of-state contractors from bidding. AshBritt CEO Randy Perkins filed a legal challenge. "This procurement in itself was nothing but charades," Perkins says. The Government Accountability Office rejected AshBritt's protest on Mar. 20; the company plans to appeal. But under special rules for companies owned by tribes, the Corps can place a contract of any size with IKBI without competitive bidding. It created a so-called bridge contract worth up to \$300 million for IKBI, according to sources familiar with the contract.

Indian-owned companies can place the work—and the money—with whatever subcontractors they want. Knoxville-based Phillips & Jordan Inc. confirms that it is the lead subcontractor on IKBI's bid. Corps officials note that no contract has yet been awarded. "Right now we're trying to figure out what our options are," says Corps spokesman Michael Logue. He wouldn't confirm or deny that IKBI is the leading contender.

The Mississippi companies hired by AshBritt to do the actual cleanup work expect to be bumped. "This Indian company is just going to sub the whole contract to an outsider, which defeats the whole purpose," said Richard Rula, president of Hemphill Construction Inc. in Florence, Miss. "Out-of-state is out-of-state, last time I checked." ■

—With Eamon Javers in Washington

FOOD FIGHT

ALFALFA SPROUTS, AISLE 78

Wal-Mart's move into organic foods has small farmers and the health-conscious bristling

BY PALLAVI GOGOI

ORGANIC IS HOT. YOU might think this would make small organic farmers happy. Well, they're not. Giants such as Kraft Foods Inc. and Dean Foods Co. have grabbed a large chunk of the market, and now retail juggernaut Wal-Mart Stores Inc. plans to double its selection of organic offerings. "Wal-Mart has the reputation of beating up on its suppliers," says Richard DeWilde, an organic farmer who grows Swiss chard, parsnips,

"We don't think you should have to have a lot of money to feed your family organic foods," he said at the company's annual meeting last year.

It's easy to see why the big boys are salivating over the organic market. It has grown 20% annually for five years, compared with 3% to 4% for the industry as a whole. And it's highly profitable. According to an OCA study, consumers are willing to pay 50% more for foods that have not been genetically modified.

Import worries are not unfounded. Cummins estimates that 10% of organic foods like meat and citrus come from



turnips, and kale on 100 acres in Wisconsin. "I certainly don't see 'selling at a lower price' as an opportunity."

Price pressure isn't the only thing that worries DeWilde. He and other farmers fear that the corporate giants could try to water down the standards for what is classified as organic food, which would facilitate more imports. "Wal-Mart already sources a majority of its products from China. Why not foods?" asks Ronnie Cummins, director of the Organic Consumers Assn. (OCA), a nonprofit group that promotes natural and organic food.

Wal-Mart didn't return phone calls seeking comment. But CEO Lee Scott has been clear about his company's goals.

Big squeeze: Purists fear the food chains will water down standards

abroad. Dallas-based Dean Foods, the biggest U.S. milk producer, buys organic soybeans from China and Brazil to make its best-selling Silk-brand soy milk.

Anxiety about standards is also legit. Large companies have already flexed their muscles in Washington. Last fall, the Organic Trade Assn.,

which represents companies like Kraft and Dean, lobbied to allow certain synthetic food substances in the preparation, processing, and packaging of organic foods. That outraged organic activists. Nevertheless, the bill was approved, and the new standards will go into effect later this year. ■



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Immigration Reform: Why Business Could Get Burned

BY RICHARD S. DUNHAM

HOW IMPORTANT IS IMMIGRATION TO THE BUSINESS community? Very. On Mar. 16, Bill Gates trekked to Capitol Hill to tell key leaders of both parties that immigration is Microsoft's No.1 issue in Washington. "If we hope to maintain our economic and intellectual leadership in

the U.S., we must renew this commitment," Gates said in an earlier letter to lawmakers. "Unless there is reform, American competitiveness will suffer as other countries benefit from the international talent that U.S. employers cannot hire or retain."

Both Sides Now

GATES AND HIS FELLOW CEOs have good reason to be nervous. Politicians in both parties are seizing on public concern about 12 million illegal immigrants living in the U.S. to craft legislation limiting cross-border mobility for skilled and unskilled workers alike. And while corporations are accustomed to anti-business potshots from the Left, they are now fighting a defensive battle against angry populist Republicans who want to seal the border and punish companies that employ illegals. At the Conservative Political Action Conference in February, Representative Tom Tancredo (R-Colo.) won a standing ovation for skewering companies that profit from imported labor. "The conservative movement can either be the voice of principle or it can be the voice of the Chamber of Commerce," Tancredo roared. "But it cannot be both."

Facing rhetoric like that, many corporations feel pressured. By opposing the GOP's anti-immigrant faction business runs the risk of ushering in more Democrats in the 2006 elections. But Tancredo and his allies pose a more immediate threat to business' long-term need for a steady stream of foreign workers.

The immigration hardliners want serious penalties to make businesses think twice before hiring immigrants. Legislation approved by the



House in late 2005 would make it a felony for businesses to hire illegal workers: Companies that incorrectly fill out certain paperwork on employees could be fined up to \$25,000. "It doesn't take too many of those [fines] to drive a small business out of business," says John Gay of the National Restaurant Assn.

Business is doing better in the Senate. Corporate lobbyists believe they have the votes to water down the tough financial penalties and win their top priority, a guest-worker program that lets foreigners take jobs Americans don't fill.

But the prospect of a House-Senate negotiation has the business community on edge. A compromise is likely to include lan-

guage requiring companies to confirm the legal status of all employees and prospective hires. Angelo I. Amador, the U.S. Chamber of Commerce's immigration policy director, says that plan would be a bureaucratic nightmare costing employers at least \$12 billion for compliance. The current federal pilot program to confirm whether employees are legally in the U.S. has been unreliable, he adds.

Yet business must tread carefully to avoid angering GOP immigration foes. "I'm worried that the clearly harsh voices in the Republican Party are the loudest voices," says former House Majority Leader Dick Armey (R-Tex.), leader of a pro-business coalition. Business frets that populism could foster a GOP faction hostile to such corporate priorities as trade liberalization and tax breaks. Already, the political schism has sparked showdowns in Republican primaries between anti-immigrant candidates and business community favorites. Among the contests: the San Diego district long represented by convicted ex-congressman

SHOW OF LABOR FORCE Protesting in Trenton, N.J.

Randy "Duke" Cunningham and the districts of retiring Republican Representatives Butch Otter of Idaho and Jim Kolbe of Arizona.

Business is digging in for a long battle. "This is a long-term issue, because this is a workforce issue," says Bernadette Budde, senior vice-president of the Business Industry Political Action Committee. "We're going to have to find labor someplace." But corporate critics don't cut companies any slack. "The illegal immigration lobby in the U.S. is big business," says Tancredo spokesman Will Adams. "They have an addiction to cheap labor."

With struggling President Bush mired in an unpopular war, GOP discord over immigration is just one more threat to the party's grip on Congress this fall. Democrats, says independent political analyst Charlie Cook, "have settled into their seats with popcorn to enjoy the spectacle of Republicans ripping themselves apart." That's a lot easier than coming up with a solution to this divisive issue. ■

One new proposal could cost employers \$12 billion in compliance

TURNAROUNDS

ANYTHING BUT STODGY

Barclays' Bob Diamond has turned the once-troubled investment banking unit into a powerhouse

BY STANLEY REED

BOB DIAMOND, PRESIDENT of Barclays PLC, loves to tell the story to each year's crop of new managing directors. In 1997, Barclays' investment banking unit was so marginal that its centuries-old parent, Barclays, dumped most of its businesses, including equities and mergers and acquisitions. All that was left was a bond business and a few other odds and ends, rechristened Barclays Capital. British newspapers at the time quickly dubbed the unit "the rump" of Barclays. Says Diamond, an American from Massachusetts who has been running Barclays Capital since that inauspicious beginning: "That wasn't the best branding I have ever seen."

Barclays' decision to focus on the staid world of bonds seemed like a suspect move at a time when the likes of Goldman, Sachs & Co. and Morgan Stanley were thriving on initial public offerings and M&A. Yet nine years later, once-puny Barclays Capital is churning out profits that its U.S. rivals would hardly sneeze at. Diamond has parlayed Barclays into a world-leading debt, derivatives, and commodities business that has been chalking up growth in the 20% range year after year. Pretax profits at Barclays Capital were up 25% in 2005, to \$2.2 billion, on revenue of more than \$7 billion. For 2006, David S. Williams, a Morgan Stanley analyst, forecasts a 12% rise in revenues to \$8.2 billion, with profits up 8% to \$2.4 billion.

So far this year, Barclays Capital is the largest debt player in Europe, and the third largest globally. San Francisco-based asset manager Barclays Global Investors, which Diamond has also headed since 2002, holds the No. 1 position in exchange-traded funds, packages of securities designed to give investors low-cost

exposure to anything from indexes to industrial sectors. Its pretax profits surged 61% last year, to \$940 million. Barclays Capital and Global Investors accounted for about a third of overall profits last year but two-thirds of the company's profit growth.

LOOKING GOOD

OF COURSE, BARCLAYS' fortunes could change. If interest rates continue to rise, corporate issuance might slow and investors might have less appetite for its yield-enhancing products. A bigger concern would be some sudden loss of confidence in the markets—another terrorist attack, say, or a regional stock market collapse—that would chill demand for financial risk. Diamond is "smart and a

good leader," says one top investment banker. "But he is not untouchable."

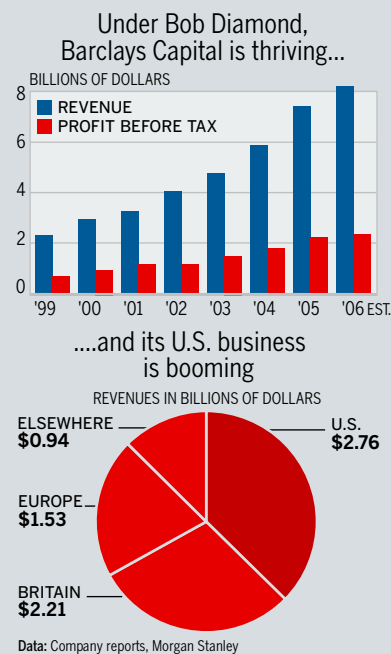
So far, he's sure looking good. Diamond, who came to Barclays after senior posts at Morgan Stanley and Credit Suisse First Boston in New York, London, and Tokyo, is an ultracompetitive former high school football star. His office at Canary Wharf is festooned with Boston Red Sox and New England Patriots memorabilia. Those who know him say Diamond is a natural leader and teacher, traits acquired, perhaps, from his late father, a teacher and school administrator whom Diamond calls "my hero." His dad finished up his career as principal of a high school on Nantucket, where Diamond today has a home.

Diamond, who taught management while getting an MBA at the University of Connecticut and who originally intended to be a business school professor, thinks culture ultimately is more essential to a bank's success than products or technology. He has been meticulous in designing the right way to hire new bankers and in tracking their subsequent performance. Job candidates are grilled in four-hour sessions and probed for flaws, especially any possible resistance to the team approach Diamond favors.

That philosophy also affects the choice of who will make managing director. After lengthy vetting, some 30 senior executives assembled in one room vote on each candidate for managing director, using electronic buttons. A score of 85% to 90% is required for success: Hotshots who alienate colleagues are told to change or leave. "We have a 'no jerk' rule around here," says Chief Operating Officer Rich Ricci.

Several of Diamond's key associates are also Americans, which has hastened the transformation of the bank's culture away from its British roots and into something much more freewheeling and entrepreneurial. Says Diamond: "We really put a lot of time and a lot of process into meas-

BARCLAYS' BIG BANG





BOSOX BANKER
Diamond has moved the bank away from its roots

uring [everyone] based on how they perform—not on who they know or how long they have been here.”

Of course, Diamond’s decision to focus on bonds a decade ago has also played a huge role in the company’s success. Low interest rates have helped spawn vast pools of liquidity, which have fostered a boom in

innovative financial products. Companies are increasingly concerned about hedging their risks from foreign exchange exposure, fuel costs, and pension liabilities. Providing financial solutions to such problems is Barclays’ meat and drink.

At the same time, investment banks such as Goldman and Morgan Stanley no

longer dominate the business. Big, integrated banks such as Barclays or JPMorgan Chase & Co. have taken market share, especially in the debt markets. It’s not hard to see why. The hefty, complex financings that companies demand today are sometimes not even possible without the backing of a powerful institution such as Barclays bank, which has an AA rating and a \$1.5 trillion balance sheet with which to guarantee deals.

MEMORY LANE

DIAMOND IS PUTTING that firepower to good use in the U.S., where Barclays Capital’s business has nearly doubled in two years, to \$2.8 billion. When Barclays first tried to do business with ACC Capital Holdings in 2003, the Orange (Calif.) company’s CEO, Aseem Mital, feared he would be dealing with “somewhat stodgy” types. He changed his mind after Barclays showed it could take on large, sophisticated deals

Hefty, complex deals are Barclays’ meat and drink

for ACC, America’s largest subprime mortgage originator.

Mital particularly likes a complex securitization dubbed “memory lane,” which allows his company to gain cash in advance from its \$80 billion portfolio of mortgage collections.

“They have become our go-to guys,” says Mital, who rewarded Barclays Capital with \$12.5 billion in coveted securitizations over the last year.

Diamond is making other moves, too. Last November, Barclays entered the U.S. commodities big leagues by taking a money-losing portfolio of derivatives off the hands of Charlotte (N.C.)-based Duke Energy Corp. for \$700 million. In the Middle East, it helped raise \$10 billion for Dubai Ports World’s recent acquisition of Britain’s P&O. Part of the financing was a \$3.5 billion “sukuk,” or convertible bond issue designed to conform to Islamic strictures against charging interest. When Deutsche Bank missed its deadline, Barclays won two-thirds of the deal, and an extra \$30 million in fees.

Is there more he can accomplish at Barclays? Diamond says: “That is the right question, and it is scary.” His name came up when Morgan Stanley was looking for a CEO last year, and he is likely to be on the short list for other top jobs. Diamond insists he’s happy right where he is. Whatever happens, he won’t be running a rump business anymore. ■

RUSSIA

A DEAL BOTH TEMPTING AND TROUBLING

Oil giant Rosneft has vast reserves, but its controversial past has investors wary

BY JASON BUSH

IMAGINE AN OIL COMPANY THAT has in five years seen its annual production and profits grow to six times their former size, making it one of the world's largest energy giants, with more proven oil reserves than Exxon Mobil Corp. Now, suppose that at a time of near-record oil prices the company plans to sell up to 49% of its shares in an initial public offering worth some \$20 billion. Investors would be champing at the bit, right?

Not necessarily. The company is Rosneft, Russia's state-owned oil giant. While it looks mighty impressive on paper, Rosneft has some skeletons in its closet that may give investors pause. With close Kremlin ties (its chairman is President Vladimir V. Putin's deputy chief of staff), Rosneft shot to prominence in 2004 when it acquired key oil assets of Yukos, the company that was hobbled after then-Chairman Mikhail Khodorkovsky was jailed on charges that defenders claim were politically motivated. The affair wiped out the value of Yukos, costing investors billions of dollars.

So Rosneft CEO Sergei M. Bogdanchikov has been pulling out the stops to impress investors. He's making the rounds of world financial centers, hinting at listings in London, New York, Frankfurt, Tokyo, and Moscow. And he's been looking for an experienced Western manager to bolster Rosneft's image. He's set to appoint Morgan Stanley's co-head of investment banking in Moscow, Peter O'Brien, to a senior position with responsibility for the IPO. (Former Commerce Secretary Donald L. Evans declined a top Rosneft job last year.)

It's all a sign of how much Rosneft—and Putin's Kremlin—have riding on the IPO's success. The company is \$11 billion

in debt, and a \$7.5 billion loan to its holding company from Western banks expires this year. The Kremlin makes no secret of its ambition to boost the value of its big state energy companies, Rosneft and natural gas provider Gazprom. In Rosneft's case, to make that happen, the company needs to get beyond its controversial past. Now, says former Putin economic adviser and current

Kremlin critic Andrei N. Illarionov, the main aim of the Rosneft IPO "is to have a so-called Western stamp of approval on all this business [with Yukos]."

The Yukos acquisition transformed Rosneft from a relatively obscure producer to a 1.5 million-barrel-a-day giant. Its 15 billion barrels in proven reserves are second only to Russian peer Lukoil among listed oil companies. What's more, Rosneft's fields are relatively young, giving it good growth prospects. "If you look at Rosneft's oil asset portfolio, it is perhaps the best in Russia," says Kaha Kiknaveidze, an oil and gas analyst at investment bank UBS in Moscow.

AMBITIOUS GOALS

BUT SHADOWS OF the Yukos affair linger. "If Rosneft had grown in a normal manner, people would be rushing to snap it up," says Stephen O'Sullivan, head of research at Moscow investment bank Deutsche UFG. "The issue is the potential legal overhang from Yukos." On Mar. 15 a consortium of international banks initiated bankruptcy proceedings against Yukos. Rosneft has already bought much of Yukos' debt, and will probably grab the company's remaining assets if Russian authorities declare Yukos bankrupt.

Another imponderable is whether Rosneft can achieve its ambitious performance goals. By 2010, the company aims to increase its oil production by 33%, to 2 million barrels a day. Some praise CEO Bogdanchikov's management, noting that even before Rosneft's acquisition of the Yukos oil fields he boosted annual production by 74% between 1999 and 2004. Helped by the high quality of its assets, Rosneft also has some of the lowest costs in the industry. But critics note that production has been stagnant at most of its major subsidiaries since 2000 and that the company's pretax earnings per barrel last year were 30% lower than those of rival Lukoil.

It's not yet clear how investors will react to a Rosneft offering. Much will depend on how its management team chooses to structure the upcoming deal. In a time when oil seems scarce, Rosneft, at the right price, might be hard to pass up, even for investors already buffeted by the shifting winds of Kremlin politics. ■

REFLECTION The oil giant is looking West to bolster its image



Rosneft At a Glance

The Russian oil giant's IPO could raise \$15 billion to \$20 billion. Here's what investors are buying:

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 OUTPUT **1.5 million barrels per day**
 REVENUES* **\$24 billion**
 NET INCOME* **\$4 billion**
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*2005

Data: Rosneft; Deloitte & Touche; BusinessWeek



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INDIA

MAKING BANGALORE SOUND LIKE BOSTON

Overseas call centers turn to e-mail and chat to handle frustrated U.S. customers

BY PETE ENGARDIO

HARI KISHAN READILY admits that he's not the best guy to put on the phone with impatient Americans. With his heavy South Indian accent and rapid, abrupt cadence, Kishan knows U.S. customers have a tough time understanding him. In any case, he says, he's "not the type of guy who likes to talk a lot."

So what is he doing processing orders for a U.S. retailer? Like growing numbers of call center agents in India, he doesn't talk. He types. Put the 26-year-old computer science grad at a keyboard, and he might as well be in Peoria. "Welcome to our wireless world," Kishan chirped to open a recent online conversation from Mphasis BFL Ltd.'s huge call center in Mangalore. He calmly tapped out crisp answers to a battery of questions from a U.S. customer frustrated that he hadn't received a cell phone he had ordered. The conversation, Kishan learned later, was a test set up by his employer with a reporter—and he passed with flying colors.

Demand for such skills is growing fast as Americans become increasingly hostile to overseas call center agents. Even if the service is actually the same as or better than what's offered by U.S.-based call centers, many Americans are turned off by foreign voices. Some 62% of U.S. consumers gripe about service if they suspect the agent is overseas—double the dissatisfaction rate with calls to agents they think are in the U.S., according to a study by Opinion Research Corp. "Irritation kicks



in when [customers] hear the accent," especially if they're already having a problem, says Mphasis Vice-Chairman Jeroen Tas. And a study by Convergys Corp., the world's biggest call center operator, with 66,000 workers in 30 countries, found that 72% of U.S. consumers claim they would

rather use automated voice systems or the Web than speak with a foreign agent.

Such perceptions matter. Nearly 7 in 10 consumers say they are less likely to do business with a company after a bad call center experience, Opinion Research says. One U.S. toy retailer told the company

it pulled all of its call-center work from India and the Philippines after frustrated buyers came into stores complaining that they couldn't understand the phone agents. "They saw a real risk of eroding their brand," says Opinion Research Senior Vice-President Linda Shea.

So companies are trying alternatives to voice calls—including online chat, e-mail, and improved automated voice systems that can resolve problems more quickly. Such services account for less than 20% of consumer inquiries today, but their share is projected to double in five years. Web-based service is a popular alternative because agents such as Kishan can be fast,

accurate typists and have superb technical knowledge. Many have spent years instant-messaging cyberbuddies in English. Chat "eliminates the accent issue," says David A. Steinberg, CEO of InPhonic Inc., the Washington (D.C.) online retailer whose calls Kishan handles. Online services can also be cheaper, since agents can handle two or three conversations simultaneously while they wait for responses from customers.

CULTURAL CUES

THAT HAS CALL center operators devoting greater resources to chat. As with telephone agents, Mphasis puts newly hired chat operators through cultural training. They read U.S. newspapers, learn that "AAMOF" means "as a matter of fact," and familiarize themselves with phrases such as "cut to the chase." By 2008, Mphasis expects about 30% of its agents will handle e-mail and chat inquiries, vs. less than 10% of its 6,500 Indian customer-care staffers today.

Still, voice calls aren't going to disappear anytime soon. Americans overwhelmingly prefer to talk to a live person rather than chat online or wade through automated phone menus. So companies are also beefing up efforts to neutralize agents' accents, and have started installing sophisticated voice analysis software to help call center personnel speak more like Americans. But as today's chat-obsessed kids grow up and start getting credit-card statements, electricity bills, and mortgages, expect them to spend plenty more time online with the likes of Hari Kishan. ■

THE STATS

69%

of Americans say they're less likely to do business with a company after a bad call center experience

62%

say their most recent experience with an overseas call center agent was disappointing

Data: Opinion Research Corp.

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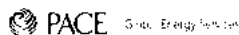
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The 2006 Global Energy Awards Call for Nominations will be issued on June 1, 2006. For more information visit www.GlobalEnergyAwards.com

The Secret Lives Of Short-Sellers

The rise of hedge funds and indie research raises new questions about a shadowy world

BY JANE SASSEEN

SITTING IN A CONFERENCE room in a Manhattan office, the researcher explains how he digs up financial information, often of the damning variety, for hedge funds and other big investors. His clients need the intelligence because they frequently sell short, meaning they bet on shares falling. "Look at the Web as a giant fish pond," he says, on the condition that he not be quoted by name. "We try to develop bait that will hook someone who knows more than anyone else."

On another day, not far away, a private investigator hired by the other side can't resist a little boast, which, of course, is not to be attributed to him. He has been employed by several companies to help prove that a group of short-selling hedge funds are fraudulently collaborating with analysts and journalists to push down stocks. He claims he has planted moles at funds and sent phony book authors to interview unsuspecting targets. "It's amazing how people just open up," he says with a grin.

SPY VS. SPY

ONCE AGAIN, the War of the Short-Sellers is surging. This time there are new twists to both public hostilities and shadowy spy-vs.-spy activity. Helping to drive the controversy is the proliferation of a breed of independent researcher prone to greater skepticism than traditional Wall Street analysts. The growing influence of these little-known characters is a by-product of the Enron-era corporate scandals, as well as New York Attorney Gen-

eral Eliot Spitzer's campaign against the overly rosy analysis produced by many Wall Street firms.

Businesses targeted by shorts are fighting back more aggressively with undercover investigations and lawsuits. Biovail Corp., a Canadian drug company, and online retailer Overstock.com Inc. claim that hedge funds run by two of the most powerful traders on Wall Street, Steven A. Cohen and David Rocker, have engaged in fraud to drive down share prices. (Those allegations have been vociferously denied.) Public relations campaigns related to the suits have drawn intense media interest, with CBS's *60 Minutes* featuring a sympathetic segment on Biovail. The Securities & Exchange Commission, meanwhile, is investigating allegations about abusive short-selling concerning the two companies, as well as potential underlying problems at both.

Criticism of short-sellers is as old as stock trading. The technique involves selling borrowed shares in hopes that prices fall so the shares can be bought back more cheaply before being returned. Some aggrieved executives accuse shorts of crushing shares with whisper campaigns. But shorts often expose hidden corporate weaknesses and have sounded early alarms about Enron, Tyco, Krispy Kreme, and many other debacles.

Pending suits by Biovail and Overstock allege a wider conspiracy than has been claimed in the past. One reason these complaints have resonated loudly is growing unease over the number and clout of hedge funds, the secretive, lightly regulated investment pools that frequently sell short. Since 2000 the number

of funds has soared from 3,873 to 8,661, according to Hedge Fund Research Inc., while assets have more than doubled, to \$1.1 trillion. "The perception is they're a bunch of cowboys, willing to do whatever it takes to get their returns," says Richard Leggett, CEO and president of the Center for Financial Research & Analysis, a forensic accounting firm whose clients include hedge funds, mutual funds, and regulators.

Short-selling has become much more prevalent. Hedge funds dedicated strictly to the technique, such as those run by famed short-seller James S. Chanos of Kynikos Associates LP, had \$603 million in assets in 2001, according to HFR; by 2005, assets in all short-only funds had grown to \$3.3 billion. Many of the thousands of hedge funds that primarily focus on "long" investing, betting that shares will rise, also short at times. Short sales on NASDAQ hit a record high of 6.2 billion shares for the month ending Mar. 15.

RABID FOR RESEARCH

THE GROWTH IN hedge funds has fueled a shift in stock research. To keep up returns, and to justify earning the highest fees on Wall Street, hedge funds have turned away from much of the research broadly distributed by investment banks. It's a commodity now. "The hedge funds will pay, but they value research that's not widely read," says Frank A. Fernandez, research director for the Securities Industry Assn., a trade group.

That trend has accelerated since Spitzer's 2002 probe of Wall Street research. One of the New York State prosecutor's goals was to jump-start the independent research industry as a counterweight to the management-friendly research big investment banks did. The settlement of the Spitzer probe also ended the practice of analysts being paid to help win banking deals from the companies they covered, leading Wall Street to cut research spending.

All that has opened the door to new, high-priced independent competitors. Two specialized categories have benefited the most: "forensic" firms, which look for suspicious accounting, and "direct research" outfits, which arrange confidential interviews with industry sources paid to answer questions posed by hedge



MATT MAHURIN

funds and other institutional investors. It all adds up to more research highlighting potential problems with company financial statements or operations, and much of it is in the hands of hedge funds that sell short. Traders and analysts sometimes pass along such reports to the media, and that has led to harder-hitting coverage of some companies.

Biovail, in its suit filed last month in state court in Essex County, N.J., alleges that Cohen's powerful hedge fund group, the \$8 billion SAC Capital Advisors, conspired to create false reports about the company's financial health with independent stock research firm Gradient Analytics Inc. of Scottsdale, Ariz. Biovail al-

leges that Gradient let the Stamford (Conn.)-based SAC "ghost-write" negative reports, which Gradient sent to other clients and journalists as its own analysis after SAC had sold Biovail shares short.

Overstock has filed a similar suit in state court in Marin County, Calif., alleging that Gradient worked with Rocker's fund to push its stock down.

SAC dismisses the charges as false and says Biovail's stock fell due to regulatory problems and its repeated failure to meet earnings targets. Gradient co-founder Carr Bettis says its research is based entirely on its analysts' views, and claims that it allowed clients to sell short ahead of reports are "absolutely false." Rocker

Partners LP also denies any wrongdoing, calling the allegations "frivolous."

Critics of the shorts say recent government investigations of other funds demonstrate that abuses do exist. The SEC has brought a string of enforcement actions against smaller hedge funds that sold stock short in connection with deals known as private investments in public equities, or PIPEs. On Mar. 14, three hedge funds and their portfolio manager, Jeffrey Thorp, agreed to pay \$15.8 million to settle fraud and insider-trading charges related to 23 PIPEs deals. Thorp allegedly obtained unregistered shares in the private placements and shorted the stock. He then used the unregistered shares to cover those short positions, a violation of federal securities law. The defendants settled without admitting or denying charges. SEC officials say they are investigating two-dozen hedge fund players involved in such deals.

THE SILENCERS

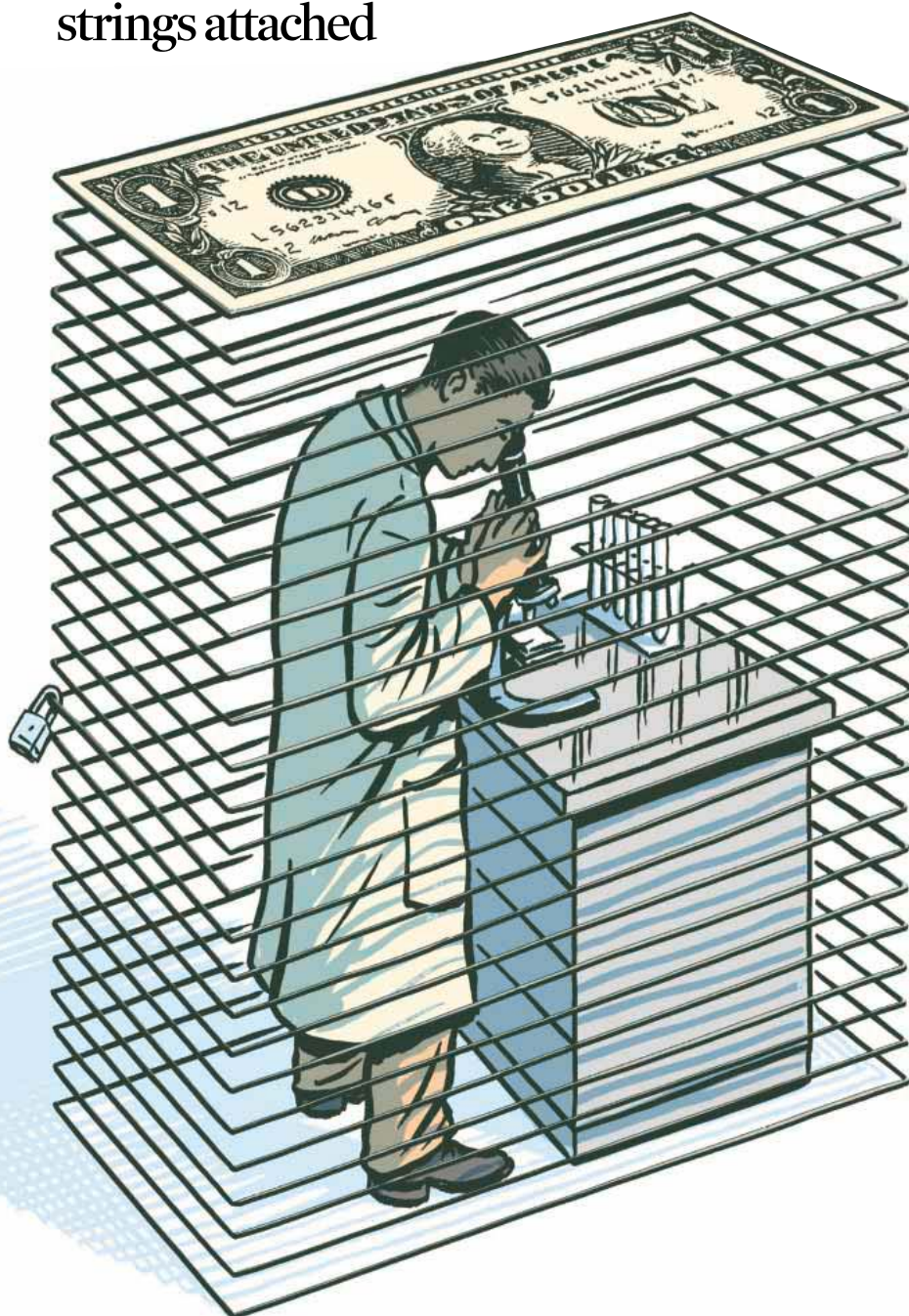
STILL, DEFENDERS OF short-selling argue that corporate critics are usually trying to divert attention from their own internal problems. Moreover, they want to silence analysts who publish critical research and discourage journalists from writing about the issues raised. "One of the more disturbing aspects of this is if they don't like what you say, then they'll use shareholder money to sue you for calling attention to their shortcomings," says Chanos, the short-seller who issued early warnings about Enron.

John O'Quinn, a plaintiffs' lawyer in Houston who has won multimillion-dollar settlements against manufacturers of cigarettes, breast implants, and diet drugs, is at the center of the escalation of the hostilities. He has coordinated an effort by a consortium of law firms over the past several years to develop cases concerning allegedly manipulative short-selling. Overstock turned to this group to press its suit in California, and Wes Christian, the day-to-day manager of O'Quinn's legal campaign, says his team has helped Biovail with its case. "When we've turned up things related to other companies, we've made sure that information got to them," says Patrick M. Byrne, Overstock's president. In this carefully orchestrated campaign, O'Quinn's group has filed lawsuits related to about nine companies in half a dozen states, Christian says. With other analyst firms and big-name funds targeted, more litigation is in the works. ■

—With Amy Borrus in Washington and Emily Thornton in New York

Biotech's Boon Or Bane?

Hedge funds are providing financing where VCs won't. But there are strings attached



BY EMILY THORNTON AND ARLENE WEINTRAUB

CASH-STARVED BIOTECH companies have what might politely be called a complicated relationship with hedge funds. Consider the tensions that built earlier this year between troubled vaccine producer Chiron Corp. and its third-largest shareholder, hedge fund ValueAct Capital. On Mar. 15, the clash between Chiron Chief Executive Howard Pien and hedge fund manager G. Mason Morfit came to a head. At issue: the proposed sale of Chiron, in Emeryville, Calif., to Swiss drug giant Novartis, which is up for shareholder approval on Apr. 12.

From his fund's San Francisco headquarters, Morfit fired off a letter to Chiron's board declining a formal invitation to meet with Pien—unless the CEO would concede that Novartis' offer to pay \$45 a share for Chiron was "not acceptable." If not, Morfit wrote, he thought Chiron's CEO should be "replaced." Five days later, Morfit wrote that he rejected Pien's personal e-mail invite to get together. "We have reviewed many times the rationale for the merger... and see no purpose in discussing [it] further," Morfit wrote in correspondence filed with the Securities & Exchange Commission. Through an e-mail from a company spokesman, Pien declined to comment on the exchange. Says Morfit: "We believe the business was turning around, and Novartis is seeking to get all the upside."

The battle between biotech CEO Pien and hedge fund manager Morfit illustrates the strains caused by a change: Hedge funds are increasingly becoming major financiers and shareholders of biotech companies. In this role, some funds act aggressively to boost share prices, in contrast to other situations in which hedge funds sell short, meaning they make bets that shares will fall. In development-stage biotech companies, the funds are stepping into a void created by the industry's traditional backers, venture capitalists, who are growing reluctant to pour millions of dollars into outfits that can take decades to generate marketable products, if they ever do. Biotechs received \$3.5 billion in VC funding in 2005, down slightly from 2004.

So biotechs are jumping into bed with hedgies more than ever before. They're doing so via private investments in public equities (PIPEs), or deals in which shares are sold to private investors, sometimes at a discount to the public share price, and

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through other stock and debt offerings. The amount of capital raised by biotechs through PIPEs alone, rose to \$2.4 billion in 2005, vs. less than \$1 billion in 2002, according to life sciences merchant bank Burrill & Co.

KNOWING THE RISKS

THE MONEY CAN come with strings attached, however. Sometimes hedge funds sell their shares immediately to lock in a quick profit, which depresses the stock price, potentially causing public investors to believe the company is in trouble. Some stock offerings are followed by bursts of short-selling, as word of the discounted deal spreads to traders who smell blood at a struggling company and go in for the kill. And sometimes, stakeholding hedge funds aren't content to sit idly by as a company struggles. They might object publicly and make other moves to undermine management.

Most biotechs know the risks to public shareholders, and yet they proceed with PIPEs and other types of private placements anyway, in the belief that their scientific breakthroughs will one day create shareholder value. Consider Novavax Inc. of Malvern, Pa. On Mar. 21, it sold \$38 million worth of stock at a 12% discount to 15 investors, most of which were hedge funds, to finance the company's development of an avian flu vaccine. Two days later, the stock tanked 12%, to a level just a penny below the discount price offered to the investors, before gaining back 3% by Mar. 28. Rahul Singhvi, Novavax' CEO, says he doesn't know why the share price fluctuated so. "We had to get money," says Singhvi. "We have such good prospects for the avian flu vaccine. As long as we have financial resources and we can do what we say we can do, the stock will ultimately do well." Hedge funds, he says, "are a necessary evil."

But are they so evil? Some experts argue that hedge funds are the perfect white knights for biotechs, whose financial prospects are so unpredictable. Clinical trials fail. Investor anger grows. Executives seek more money for research and development. Accusations are traded back and forth. "[Biotech] lends itself to speculation," says Michael M. Membrado, a New York attorney who advises early-stage companies on private placements. "The funds in private placements are in the business of speculation and do well in that arena."

The allure of hedge fund money is so strong that it seems to be enticing many biotech companies to go public earlier than they otherwise might, experts say.

Some small startups that can't attract enough investment banking interest to pull off an initial public offering are even merging into shells of failed public companies to raise funds. "This is a big trend that we haven't seen before," says Alan G. Walton, a general partner at Boston-based VC firm Oxford Bioscience Partners. He estimates that 40 biotechs will reverse-merge into shell companies in



2006, up from 28 in 2005, and that 90% of the money raised in this fashion comes from hedge funds.

Given the risks they're assuming, some hedge funds say their occasional decisions to sell a biotech company's stock right after they have helped it to raise money makes financial sense. "You get into situations where a stock hasn't gone up, or has gone slightly down, and a company comes back and says, 'I need more money,'" says Mark A. Angelo, founder and president of hedge fund Cornell Capital Partners in Jersey City. "So you say, 'I'll give you the money, but I'm going to sell what I already have because I don't have endless amounts of capital.'"

DEBATABLE DEALS

BIOTECH CEOS UNDERSTAND this reality. In fact, some aren't even worried about short-selling. "I can't lose sleep over people shorting my company's stock," says Vijay B. Samant, CEO of San Diego-based biopharmaceutical company Vical Inc., which raised \$22.6 million through a private placement last October. "I just think of how I can keep my

program growing and creating good news. Shorting the company's stock is irrelevant."

Other CEOs are even signing on to deals that could end up giving hedge funds big chunks of their companies if their share prices plummet. Last fall, stem cell researcher and developer Advanced Cell Technology Inc. raised \$18 million by agreeing to sell to investors a convertible debt

TENSION Chiron CEO Pien is under fire from hedge fund ValueAct Capital

security that the Alameda (Calif.) company might have to pay back in stock or cash in the next three years. "The [deal] in some circles would be considered toxic," admits CEO William M. Caldwell IV. But "we have confidence in what we're doing. It was a lot of incentive for investors to come into [what] in our case is a developing-stage company."

Still, plenty of CEOs see hedge funds as a nuisance. Chiron clearly isn't enthused about its dealings with ValueAct Capital. And Ontario-based Biovail Corp. has filed suit against a research company it alleges works in conjunction

with short-selling hedge funds to drive share prices down. Biovail shareholders on Mar. 24 filed a class action.

Even biotech darling Genentech Inc. in San Francisco, which boasts proven products and strong revenues, is wary of hedge funds. CEO Arthur D. Levinson lost his cool when a hedge fund manager seemed intent on shaking up the company's recent day-long meeting in New York for investors and Wall Street analysts.

Thanks in large part to its blockbuster colon cancer drug Avastin, Genentech's stock has been soaring. But during a question-and-answer session, the hedge fund manager, Howard Flinker of Flinker & Co. in New York, said a physician acquaintance "heard that deaths from Avastin are higher than what recent publicity says." Levinson shot back: "Are you with a hedge fund?" Flinker answered yes.

But he pointed out that he didn't even own Genentech shares. So what was Flinker doing at the meeting in the first place? He declined to comment. ■

—With Susan Zegel in New York

They're Off

Biotech firms are rushing to go public through so-called reverse mergers to get financing from hedge funds.

YEAR	NUMBER OF FIRMS
2006*	40
2005	28
2004	20
2003	21
2002	21
2001	12
2000	6

*Estimate Data: Oxford Bioscience Partners



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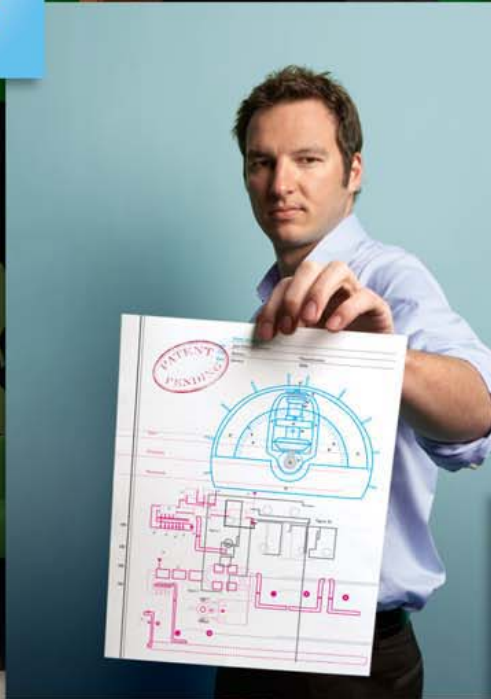
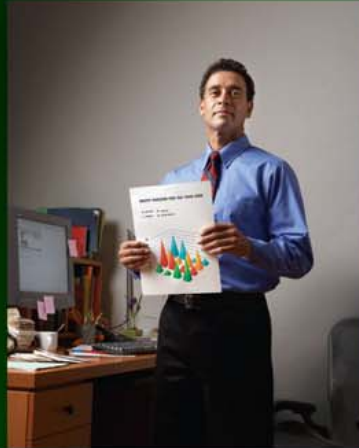


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i n v e n t

Dawn of The Idea Czar

When the 'I' in CIO is for innovation, the post should go to a jack-of-all-trades

BY JENA MCGREGOR

BILLY EDWARDS' COLLEAGUES at Advanced Micro Devices Inc. have called him their utility infielder. AMD's human resources chief Kevin Lyman calls him the chipmaker's *agent provocateur*. Officially, though, Edwards is called AMD's chief innovation officer, a newly created role for this senior vice-president.

Although Edwards, 50, has a PhD in materials science engineering and has worked around semiconductors for much of his career, he has also headed up strategy at the Sunnyvale (Calif.) company, run a startup, and worked as a consultant for The Boston Consulting Group. So when AMD formalized a role that would lead its innovation effort last September (or, as Lyman describes it, "put an 'X' on the back of someone to consciously drive it"), Edwards' diverse experience, gregarious personality, and penchant for disrupting traditional ways of thinking fit the bill. "A chief innovation officer needs to be this blend of marketer, technologist, strategist, and business person," says Lyman.

In other words, Edwards' new role goes far beyond dreaming up the next chip iteration for AMD. Rather, he'll be spearheading audacious projects that don't neatly fit into any of the company's current functions. One such example is AMD's 50 x 15 initiative, with its goal of getting Internet access to 50% of the world's population by 2015. He's also experimenting with ways to teach AMD engineers to imagine a wide range of scenarios, in an effort to re-

frame what he calls their "mental maps." And he's sponsoring contests for students to design technology solutions for the world's low-income populations, a vast and potentially huge future market for the company. "When people think about innovation, they think about inspiration, which is a little single-dimensional," says Edwards. "The most powerful [innovations] cross a lot of boundaries."

NEW HYBRID

A THIRST FOR INTERNAL growth across Corporate America has made innovation a critical management mandate. As a result, the initials "CIO" have increasingly begun to refer not to chief information officers but to yet another C-suite label, the chief innovation officer. That and similar titles, such as vice-president of innovation, are popping up in companies from Citigroup to Coca-Cola to health insurer Humana. Titles of this magnitude send a clear message to the organization: Innovation is an urgent priority and someone

should be accountable for it. Most of the large executive search firms are reporting a dramatic uptick in requests for such people. Heidrick & Struggles International Inc.'s Jane M. Stevenson, who heads the firm's global search practice for chief marketing officers, says she has seen a fourfold increase in these positions in the last three years, with most of that

Part marketer, part techie, the CIO must have the CEO's ear



growth coming in the last 18 months.

While companies have long had VP-level scientists running research and development, or marketers steering new product development, these innovation chiefs are a new hybrid breed. If they don't directly report to the chief executive, they typically have direct access and, like Edwards, their jobs are more broadly defined. As companies continue to figure out just what innovation is, managers charged with running it have seen their responsibilities evolve. Rather than encompass only new products, innovation has come to include everything from finding new business models and fresh ways to glean customer insights, to shaping a more creative corporate culture.

The structure of the role varies widely: Some CIOs have sizable teams while others are more like internal consultants, and the job may be most closely tied to strategy, marketing, or R&D. Tierney Remick, a managing director with executive search firm Korn/Ferry International, says most of the innovation officer-led teams she's seen have started small and grown over time as the responsibilities of the role have expanded.

That's the case at Humana, which

STEVE SALERNO



named its chief medical officer, Dr. Jonathan T. Lord, to the newly created post of chief innovation officer in 2001. Initially, Lord's approximately 15-person team was formed to find new innovations for Humana's core insurance products. "It was a smaller team, a smaller scope, and a narrower agenda," says Lord.

But over time, Lord's team, which is housed on the company's "Innovation Center" floor in its Louisville headquarters, has itself become a corporate func-

tion. The team has swelled to 150 employees, many of whom Lord has recruited from places like General Electric Co., Procter & Gamble Co., and the defense industry, with an eye toward bringing in outsiders' perspective and expertise. Lord now keeps a hodgepodge of corporate initiatives under his umbrella. Among them: ethnographic consumer research, external partnerships, and, beginning last year, mergers and acquisitions.

As Humana shows, there seems to be a place for innovation czars at companies of all stripes, but they are particularly hot in the food and consumer-goods industries. P&G, Kellogg, Hershey, Wm. Wrigley Jr., and Newell Rubbermaid have all added high-ranking innovation execs to their lineups in recent years. A CIO role is also becoming more common in mature companies looking for a boost to their revenues. "Companies that are still emerging through rapid growth tend not to need a separate [CIO] because most often the CEO is still the chief innovation officer," says Heidrick's Stevenson. "It's the more mature companies where perhaps [innovation] no longer remains the focus."

"SILVER-TONGUED"

ACCORDING TO HEADHUNTERS, candidates with marketing backgrounds are filling more of the newly created CIO positions. Although some level of technical knowhow—or a lot, at a tech company such as AMD—confers credibility in this cross-functional gig, CIOs have to be able to sell high-risk new ventures throughout often-skeptical corporate fiefdoms. "Marketers are typically pretty silver-tongued," says Greg Welch, who heads up the marketing officer practice for executive search firm Spencer Stuart. "They know how to whisper 'this is our initiative' to the CEO and [win support] more so than some 20-year R&D person."

Whether the CIO is a battle-tested company vet or a fresh-thinking outsider, idea generators with little experience implementing them aren't right for the role. That's one reason why Yankee Candle Co. chose veteran brand manager Rick R. Ruffolo when it expanded its chief marketing officer role to link R&D, brand strategy, and marketing. Before arriving at Yankee Candle in September, Ruffolo had launched new product lines for Limited Brands' Bath & Body Works and managed brands at S.C. Johnson & Son and P&G. Now the product development and marketing departments report through Ruffolo, whose business card reads senior vice-president of brand, marketing, and innovation.

If that title's a mouthful, consider the multifarious duties that confront Ruffolo: establishing a more disciplined way to evaluate and execute ideas, meeting with operations about innovative manufacturing processes, and scouting global markets for new devices to deliver Yankee Candle's fragrances. "If it was just a purely innovation role, I might just run after all these different gadgets," says Ruffolo. "But by linking it to a senior management role, it's not innovation for the sake of innovation."

For Ruffolo, the chief innovation post meant a higher level of seniority; for Lord, becoming a CIO was largely an expansion of his responsibilities. Still, the CIO job is hardly an established rung on the standard-issue corporate ladder—and the risk of failure is high. But able candidates are drawn by the position's high visibility and the rewards that could accompany any successes. "If they're incubating truly new businesses, they could ultimately go run [one of them]," says Spencer Stuart consultant Cathy Anterasian. "That's very exciting." ■

—With Amy Barrett in Philadelphia

PLAYBOOK: BEST-PRACTICE IDEAS

Beyond **R&D**

How to make chief innovation officers effective:

LOOK FOR TRACK RECORDS

Don't be tempted by prolific idea generators with no history of execution. Knowing how to implement new products or processes and how to navigate an organization matters more.

HIRE PERSUASIVE PEOPLE

Many CIOs will have direct reports that are in different functions, such as marketing or operations. Rallying those folks to the innovation cause is essential for success.

GIVE THEM ACCESS

CIOs will falter without true top-level support, especially if culture change is part of the job. "There are just very few people who can drive that without the ear of the CEO," says Heidrick's Stevenson.

USE DIFFERENT YARDSTICKS

Innovation officers won't gain credibility unless they show results. But they'll need extended time frames, cooperation, and more tolerance for failed experiments.

CARVE OUT SPACE

Humana transformed a floor of its headquarters for its innovation team. Managers come and go, but changing the actual space of the office sends a clear signal of importance.



Steve & Barry's Rules the Mall

The fast-growing clothing chain manages to underprice even Wal-Mart

BY ROBERT BERNER

STEVEN SHORE AND BARRY Prevor love to fill a void—about 3.5 million square feet of it. That's how much space Steve & Barry's University Sportswear took in U.S. shopping centers last year, the most of any mall-based chain.

The co-CEOs soaked up that space by opening 62 supermarket-size stores, almost doubling their outlets in one year, to 134. The privately held chain, which lures shoppers with casual clothing priced at \$7.98 or less—a 40% discount to prices at Wal-Mart Stores Inc. and Target Corp.—plans to operate more than 200 stores by yearend. The key to the rapid growth: a highly opportunistic business model that relies on aggressive incentives from mall owners, creative apparel sourcing, and virtually no advertising. “They are the most talked-about retailer in the mall industry,” says Norman Peters, senior vice-president for real estate at Cafaro Co., a

Youngstown (Ohio) mall owner. “They’re on everyone’s list [of preferred tenants].”

Steve and Barry, both 42, opened their first store near Philadelphia’s University of Pennsylvania in 1985, while Prevor was getting an undergraduate degree at its Wharton School. The childhood friends sold university-logoed sportswear at prices that easily undercut the expensive gear at college bookstores, doing so well that they opened stores in a handful of other university towns and then in malls. The chain, based in Port Washington, N.Y., now offers humorous T-shirts and an increasing amount of basic clothing for men, women, and kids, such as jeans, cargo pants, woven shirts, and jackets. What really draws shoppers, though, is decent quality at such low prices. “Nothing beats \$7.98 except free,” says Florence Luka, 37, flipping through racks of shirts at a Steve & Barry’s in West Dundee, Ill.

How can Steve & Barry’s charge so little? One reason: the cut-rate deals it negotiates with landlords. Most of its stores are

SHORE AND PREVOR in middle-market malls, which have seen rising vacancies, due to the closure of regional dis-

counters, department store consolidation, and loss of business to powerful off-mall retailers. “Some of these [mall owners] are desperate,” says Deutsche Bank real estate analyst Louis Taylor. So as the chain’s popularity has risen and store size has increased, it has been able to negotiate lease rates that are less than half those of most mall tenants, says Prevor.

SAVVY PURCHASING

LOW RENTS ARE HARDLY the only way the men keep costs low. While malls usually give new tenants allowances of \$20 to \$30 a square foot to build interiors, the popularity of Steve & Barry’s has allowed the chain to command “build-out” fees as high as \$80, considerably more than actual costs, says Ivan L. Friedman of Retail Consulting Services Inc., which advises retailers on real estate issues. That’s enough to cover a store’s initial inventory, lowering operational costs further, he adds. Prevor denies that mall payments exceed actual interior costs. Even so, he says, there’s no question the fees “fuel our growth.”

Steve & Barry’s also saves money in purchasing. It buys direct from overseas factories, like many others, but cuts costs by accepting longer lead times. It also saves by offering steady production throughout the year rather than seasonal ramp-ups. The chain cuts expenses further by deft navigation of import quotas and duties, says Prevor, who can rattle off such rules the way a tax lawyer does the Internal Revenue Service code. That’s why it buys more from factories in Africa and less from China than many rivals—most African countries face neither U.S. quotas nor duties. Advertising isn’t an expense Steve & Barry’s wrestles with, either—it relies mostly on word of mouth. Salaries are modest, and a third of its 220-person headquarters staff are recent college grads.

Can Steve & Barry’s retain its edge? Prevor says he wants to maintain the 10-year compounded sales growth rate of 70%, aiming for 568 stores by 2008. (The chain is profitable, he says, but he won’t give figures.) Leaving aside the operational challenges, Marshall Cohen, chief retail analyst for researcher NPD Groups Inc., notes that the company’s model is easy to copy—and Wal-Mart and Target could match its prices on key items. A Steve & Barry’s stumble, though, would make many mall owners unhappy. Especially the ones who are helping to bankroll its growth. ■

ARA KOEPLIAN



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Twilight Of the UAW

The pressure to make wage and benefit concessions won't go away

BY DAVID WELCH

FOR MORE THAN TWO decades, the United Auto Workers has grudgingly allowed Detroit carmakers to slash jobs as they have struggled to keep pace with the onslaught from foreign rivals.

That's what UAW President Ron Gettelfinger agreed to when he signed off on General Motors Corp.'s buyout of more than 40,000 jobs at the No. 1 carmaker and its former parts unit, bankrupt Delphi Corp. Where the union has always drawn the line is on bedrock issues: wages and benefits for workers and retirees.

This time, though, that line won't hold. GM's buyouts are the beginning, not the end, of the concessions the union will have to make over the next few years. Unless GM and Ford Motor Co. see miraculous sales rebounds, the UAW at last will have to give ground on pay and health care. Already, Delphi's tough-talking chairman, Robert S. "Steve" Miller Jr., has issued an ultimatum requiring pay cuts of nearly 40% for the remaining 12,000 Delphi workers who can't take GM's offer. If the union continues to refuse, Miller could impose a harsher labor deal in bankruptcy court.

Gettelfinger can't look for relief across town, either. Ford has already announced plans to slash 25,000 jobs and will likely do a buyout deal, too. Similarly, bankrupt auto parts makers—including Collins & Aikman, Dana, and Tower Automotive — are using the courts to cut pay or close factories. Says a high-level official at another union: "This is a leadership moment for the UAW. We've had to deal with this in steel and airlines; now it's autos' turn."

What's going on is nothing less than the slow death of what was once the

country's most powerful industrial union. Despite years of relentless global pressure, the UAW has been able to maintain some of the best blue-collar posts in the U.S. But like lumbering GM itself, the union failed to realize what it would take to compete in a world economy. In the 1980s and 1990s, it fought concessions that would have helped U.S. carmakers fend off imports. The upshot: Like GM and Ford, it's paying the price today.

This year alone, the UAW will lose about 70,000 of its 640,000 members as a result of cuts at Ford, GM, and Delphi, bringing total membership to well under 600,000, vs. 1.5 million in 1980. At the same time, wages at parts makers are plunging and the paid-layoff clause, known in Detroit as the JOBS bank, is certain to be vulnerable when Big Three executives and UAW leaders face off in bargaining next year. Add it all up, and "this is the decline of the UAW," says Sean McAlinden, chief economist with the Center for Automotive Research in Ann Arbor, Mich. "We're in the 21st century. It's over."

The UAW's setbacks highlight a broader challenge faced by blue-collar America. Just as union bargaining muscle helped make the middle class, so too does its weakening signal the stiffer barriers less-



ON THE LINE UAW President Gettelfinger (left) is hanging tough, but a face-off is coming

skilled workers face in today's globalized economy. Just 52% of households headed by someone with only a high school degree are middle-class in 2003, vs. 68% in 1969, according to the National Center on Education & the Economy in Washington. "There are still opportunities for those without higher education, but they're shrinking every year," says NCEE Senior Fellow Anthony Carnevale.

BRINGING IN BUYOUTS

UAW LEADERS bristle at the thought that they are losing clout. Gettelfinger told *BusinessWeek* in an interview last year that "every Labor Day there are stories written that we're going away. But we're still here." True, he does still wield tremendous power over the Big Three. He negotiated buyouts of \$35,000 to \$140,000 from GM rather than pink slips for workers. GM will fund the estimated \$4 billion to \$5 billion in total restructuring costs for its plants and those of Delphi by sell-

(TOP TO BOTTOM) BILL PUGLIANO/GETTY IMAGES; TOM PIDGEON/BLOOMBERG NEWS

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ing off parts of its General Motors Acceptance Corp. finance arm and its stakes in Japanese auto companies, which is what Gettelfinger really wanted. And so far, the cuts to health-care benefits still leave his retirees with a better medical deal than most employees have. Nor have hourly workers yet lost ground in health care.

But the UAW's grip on wages and benefits can't last. America's employer-paid medical insurance amounts to an ever-increasing tax on domestic manufacturers trying to compete with foreign rivals based in countries with nationalized health care. Meanwhile, foreign auto makers get state and local tax breaks to build new plants in the U.S. that in some cases amount to five years' worth of their wage bill, says AlixPartners LLC Managing Director John Hoffecker.

CHINESE AUTOS ON THE WAY

THERE'S ANOTHER buzzsaw coming: cars from China. Every big auto maker is expanding production in the Chinese market, and analysts expect most to start exporting vehicles to the U.S. in a few years. "Chinese cars are coming," says Harvard University economics professor Richard Freeman. "I don't know if the UAW can hold on to its wages and benefits [in the face of that]."

The UAW's prospects look eerily similar to those that once faced another old-line union, the United Steelworkers. In 2002, after decades of relentless battering from global rivals, most U.S. steel-makers were hopelessly uncompetitive. To salvage what was left of the industry, the Steelworkers agreed to cut wages and benefits as well as jobs.

Most dramatically, the union allowed players such as U.S. Steel Corp. and Bethlehem Steel Corp.—then headed by none other than Delphi's Miller—to all but wipe out their legacy costs. The companies ended retiree health plans and used bankruptcy court to dump pension plans onto the federal government, cleaning billions off their books and out of steelworker retirees' pockets.

The UAW appears to be headed down the same path. "We were told by our union that we can expect to see a very different Delphi," says Skip Dzedzic, shop committee chairman of UAW Local 1868 near Milwaukee. "And I think we will." UAW workers can also expect to see a very different auto industry, and because their fortunes are so intertwined, a vastly diminished union. ■

—With Aaron Bernstein in Washington

Way Beyond Home Videos

YouTube could be a new NBC—or another Napster

BY HEATHER GREEN

ALL CHAD HURLEY AND Steve Chen wanted to do was share some videos from a dinner party with a half-dozen friends in San Francisco. It was January, 2005, and they couldn't figure out a good solution. Sending the clips around by e-mail was a bust: The e-mails kept getting rejected because they were so big. Posting the videos online was a headache, too. So last February the two buddies got to work in Hurley's garage, determined to design something simpler.

What they came up with is a Web site, now called YouTube, that has become an Internet phenomenon. In 11 months the site has become one of the most popular on the Net. It shows 30 million videos a day and drew 9.1 million people in February, says Web measurement service Nielsen//NetRatings. That makes the upstart one of the biggest providers of videos on the Net, ahead of Yahoo! and Google and just behind Microsoft, according to the Nielsen//NetRatings estimates.

Why has the site caught on so fast? Chen and Hurley designed it so people

can post almost anything they like on YouTube in minutes. The result is something like the TV station you always dreamed of. YouTube offers mainstream shows from the current season, clips from TV's earliest days, and homemade movies from around the world. You watch what you want when you want, whether it's highlights from Los Angeles Laker Kobe Bryant's 81-point outburst in January or a 1968 clip of Johnny Cash performing *Ring of Fire*. Members, who can comment on videos and set up their own sites on YouTube, are adding 30,000 new videos a day. "From Day One we concentrated on building a service and community around video," says Chen. "That made us a lot different from the iTunes and the Googles out there."

TOO OPEN?

THE TROUBLE IS, THE freewheeling approach that has made YouTube a hit could be its downfall. Users have been posting videos that are still under copyright, without any of the required legal approvals. These include clips from the Olympics, prime-time news shows, episodes of *The Office*, and music videos. Needless to say, this doesn't sit well with

(TOP) ROBERT CARDIN



THE HURLEY AND CHEN SHOW
Pals since early days together at PayPal

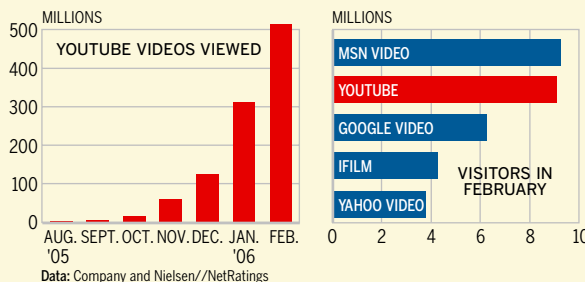
the major media companies. NBC, CBS, and others have requested that YouTube remove clips taken from them. Hurley and Chen typically don't screen out copyrighted works before they're posted, but they do comply with all such requests.

That raises the question: What does YouTube want to be when it grows up? Is it the next NBC or the next Napster? Hurley and Chen think they're working toward the future of TV. Venture stalwart Sequoia Capital is betting on the prospect, having invested \$3.5 million. But skeptics wonder if the startup can balance its surging popularity with the looming legal risks. "I think YouTube is fantastic," says Joanne Bradford, head of sales at MSN and other Microsoft properties. "But five years from now I don't know how they make their money. Their problem is all the pirated content."

The next few months will be critical. Hurley and Chen are investigating whether they can generate revenues by adding advertising. They're also working to convince media companies that YouTube can be a good partner, capable of delivering an audience of millions. The San Mateo (Calif.) company is rolling out tools aimed at protecting copyrighted

YOUTUBE'S LIFTOFF

YouTube is rocketing to popularity through a mix of community features, homemade videos, and copyrighted works



works, including technology that prevents clips from being uploaded again once they've been removed. They're also limiting videos to 10 minutes to cut out entire TV episodes and movies. "We want to be a destination that promotes the entertainment offered by these guys," says Hurley, YouTube's chief executive.

Some major players are showing interest. Marketers for Nike Inc. used the site to run a spot of soccer star Ronaldinho showing off with a new pair of Nike shoes. Satellite TV service BSkyB, which distributes *The Simpsons*, posted a live-action version of the animated show's famous intro to promote it in Britain. And Matador Records is marketing several bands on YouTube with specially created video contests and biographical clips. "We love the Tube," says Adam Farrell, Matador's online marketer. "Their numbers are undeniable."

Hurley, 29, and Chen, 27, feel at home in turbulent times. They got their start in the business world during the dot-com bubble and the bust that followed. They were among the first 20 hires at online payment service PayPal Inc., joining during the second half of 1999. They got to know each other well during the lean years, becoming part of a tight-knit PayPal mafia that remains close today. Their venture money came in part through their connection to Roelof Botha, a Sequoia Capital partner who had been PayPal's CFO.

A key lesson Hurley and Chen learned from the PayPal days is flexibility. PayPal's founders started out providing security software for handhelds and then

tried several other fields. Only later did they hit on the idea for their on-line payment system, a business that eventually was sold to eBay Inc. for \$1.5 billion in 2002.

Hurley had an entrepreneurial streak from the start. He grew up in the Philadelphia suburbs and as a 5-year-old tried to sell paintings from his front yard. He studied design at Indiana University of Penn-

sylvania and landed at PayPal after reading about it in *Wired* magazine and sending an e-mail inquiry about a job. During his interview he designed a new logo for PayPal, one that executives liked so much they still use it today. He left after the eBay deal, working with a few companies as a design consultant.

ELUSIVE BALANCE

CHEN, YOUTUBE'S chief technology officer, has been a math and science geek since high school. He threw himself into programming and computers at Illinois Mathematics & Science Academy and went on to study computer science at the University of Illinois at Urbana-Champaign. During his last semester he was recruited by Max Levchin, co-founder of PayPal and a former classmate. Chen remained at PayPal until early

last year to help finish launching the company's expansion into China.

In the year since, Chen and Hurley have come a long way. Yet they are still searching for the right balance to turn their sudden popularity into profits. If they cater too much to their users, they risk getting sued for copyright violations and losing the support of content companies. If they're seen as favoring content companies, however, they could lose their millions of fans. It's a challenge they couldn't have imagined a year ago. "We started this to solve a personal problem," says Hurley. "Now we're creating a new way to reach audiences in an era where the traditional TV time slot doesn't exist anymore." ■



ANYTHING GOES YouTube viewers can post clips of *Scary Movie 4*, Johnny Cash in concert, and *Wayne's World*

BY SARAH LACY

ONE WEEKEND BACK IN December, Marc Fleury was hunched over his computer, absorbed in writing a fervent, almost preachy and completely self-serving blog about why IBM and BEA Systems Inc. will never be able to best his tiny but growing open-source company, JBoss Inc. His 6-year-old daughter walked up to him and asked: "Daddy, why are you still working on a Sunday? Is IBM still after you?" He laughed and replied: "Yes, darling...but now a whole industry is ganging up on us."

That's life in the Fleury household. The entrepreneur's favorite movie is *The Matrix* because, like its protagonist, Neo, he has long fancied himself working a boring day job and then saving the world at night. Fleury's company, JBoss, is a key player in the booming open-source movement that's shaking up every software company from Microsoft to Oracle to IBM, forcing them all to change their strategies or to collaborate with younger, faster-moving competitors that develop "open" software, distribute it freely on the Net, and make money by providing support and training for it. When JBoss took in venture capital in 2004, it was valued at \$200 million, and those close to the company say Fleury and his family own nearly 50%.

PROFIT MOTIVE

BUT WHILE FLEURY, like Neo, is something of a cult figure, few people in the old or new software world want to think of him as their savior. Brash, outspoken, and frequently insulting, Fleury has clawed his way to the top of the open-source pile over the past six years. Part of the dislike arises because he's a threat. Even though JBoss brings in only \$50 million a year in revenues, at most, from providing training, support, and maintenance services to its users, it has siphoned off some hundreds of millions in market value from the likes of BEA Systems and IBM by giving away free software.

Meanwhile, some open-source companies are put off by what they say is Fleury's money-grubbing, controlling style. It's out of keeping, they say, with the cooperative, do-it-for-the-greater-good ethos of the open-source movement. Stuart F. Cohen, head of Open Source Development Labs Inc. (OSDL), a nonprofit group that advocates for the development of Linux, the open-source operating system, remembers the first time he met Fleury. He had been invited to Atlanta to be on a panel at a JBoss customer event,

An Open-Source Lightning Rod

Marc Fleury has taken JBoss to the top, but he has alienated many along the way



and Fleury kept asking when he was going to take OSDL public. "To him, everyone is out to make money," he says. "That's not what this idea is really all about." Even competitors from the traditional software world criticize Fleury for having what they say is a cynical profit motive. "Marc Fleury has really exploited the open-source hype for his own personal financial gain," says one. Fleury's reply: "That's like someone telling the rapper 50 Cent he's not street enough."

If Fleury is focused on making money,

perhaps that's because he spent a few frustrating years in Silicon Valley making none. His ambitions were nearly crushed in 2001 when he and his wife, Nathalie, and their young daughter left Silicon Valley penniless after he had spent years trying to build a software hosting company called Telkel. He was disillusioned and sick of playing the Silicon Valley game: putting

FLEURY at his in-laws' Atlanta home, where he lived during the dot-com bust after an early startup failed

MARK ANDERSON

together a business plan and shopping it around to “snooty” venture capitalists.

So he moved into his in-laws’ house in Atlanta and focused on contributing to an open-source project that he and others had started in 1999, JBoss. All he wanted to do, he told his wife, was write code for free all day long. “She told me I was stupid,” he says, and gave him a year to make \$70,000 or else get a job. Then companies downloading JBoss software started asking him for training and support—and offering to pay. A year later, Fleury had made more than \$100,000.

DEMANDING PERSONALITY

HE’S WORTH A LOT more now, to the dismay of his critics. Some investors have even refused to invest in JBoss because of Fleury’s style. “It’s a strength and a weakness,” says David R. Skok, a partner at Matrix and the company’s biggest outside investor. “Because he’s so disliked, it creates incredible controversy and incredible press. I think he knows that, and kind of plays that up.” His personality may have played a part in what insiders say was an offer from Oracle Corp. earlier this year that fell apart. Oracle is said to have valued the small company at nearly \$500 million—a big endorsement of open source that had entrepreneurs and venture capitalists licking their chops along with JBoss employees, who own a large chunk of its stock.

Neither Fleury nor Oracle will comment on what happened, but insiders say the deal died because of Fleury’s demands about what his role would be at the combined company. With Oracle paying such a premium, the deal was going to be integrated its way, not his. Fleury will say only this: “One of the conditions of me selling to anyone is we remain whole and I remain the boss.”

Fleury owns up to the reputation that he has developed. Sitting in an unkempt office in a flashy Atlanta building, he downs a giant cup of coffee before dribbling Visine into red-rimmed eyes. He spits sunflower seeds in a cup as he talks about why people hate him. The old software world? They’re jealous. Open-source zealots? “They probably hate me at night because they didn’t have the *co-jones* to go out and do [what I’ve done].”

Of course, no one says you have to be a nice guy to make it in software—just ask people who have worked for Microsoft’s Bill Gates or Oracle’s Lawrence J. Ellison, whom Fleury names as personal heroes. And although Fleury didn’t write the most salient parts of JBoss code and wasn’t the one to fine-tune the business model, JBoss

probably wouldn’t be where it is without him. As much as he is despised outside the company, its executives and developers describe him as the visionary who holds JBoss together. “The public face of Marc is very abrasive, but inside the company, he really cares a lot about what you have to say,” says Sacha Labourey, JBoss’s chief technology officer and one of its first employees.

Fleury has hired some of the best contributors to the open-source project, who work for him remotely from around the world. He fancies himself a sort of record label managing “rock stars.” He has always wanted to be a hotshot programmer himself. During his first tech job at Sun Microsystems Inc. in France, the company kept trying to push him into sales or middle management, and he insisted on soft-

“Inside the company, he really cares a lot about what you have to say”

The details: “We are going to get this horrible stretch limo and go out to dinner and [the clubs].”

A few weeks ago, Fleury’s daughter had another question for him: “Daddy, is JBoss still going to be around when I’m big?” She’s not the only one wondering about that. Red Hat, Novell, and Oracle are all said to be interested in the company. But

quietly, several industry watchers say the cocksure Fleury blew his chance. Aside from Red Hat, there are few businesses that have proved they can scale up using the free-software model. Red Hat’s steep earnings multiple, which tops 80, along with the \$500 million that venture capitalists pumped into startups last year have some worried about an open-source bubble that may be nearing its limit.

If Fleury is kicking himself, he’s cer-

BIO

Marc Fleury

Brash and outspoken, he sees himself as one of the good guys



BORN Nov. 22, 1968, Paris.

CAREER Began tech career in sales at Sun

Microsystems in France before moving to Silicon Valley in 1997 to work for Sun as a programmer. Started the JBoss project in 1999, along with a software hosting startup called Telkel that ultimately failed. Moved to Atlanta in 2001 to pursue JBoss.

INDUSTRY HEROES Bill Gates, Larry Ellison, and Linus Torvalds.

EDUCATION BS in mathematics, Ecole Polytechnique in Paris, 1991; masters in theoretical physics, Ecole Normale in Paris, 1992; PhD

in physics, Ecole Polytechnique, 1996, for work done as a visiting scientist at Massachusetts Institute of Technology.

FAMILY Wife, Nathalie, a six-year-old daughter, and twin three-year-old boys.

FAVORITE FLICK *The Matrix*, hands down. “As corny as it is, I totally identify with Neo: boring job at day, and at night I save the world. And what’s not to like about Trinity?” he says, describing the film’s female lead and making a purring noise.

HOBBIES Skiing, PlayStation, techno music, learning to figure skate with his daughter.

ware development. When he came to Silicon Valley with Sun in 1997, he continued to be frustrated when he couldn’t break into its elite programming teams.

Now, as an employer of elite programmers, he gives them the freedom to take months on projects of their choosing. He rewards them with “genius grants” when they do something particularly innovative. “Managing superstars is one of the things I can do,” he says. As Fleury talked to *BusinessWeek*, he was planning a surprise birthday bash for one of his “geniuses.”

tainly not doing it publicly. He and his investors say they’re focused on getting ready for an initial public offering, which will come “sooner rather than later,” according to Chief Operating Officer Rob Bearden. “They’ll be rich,” Fleury boldly says of investors and employees. “I’ll create a generation of open-source millionaires, and I’m damn proud of that.” ■

—With Brian Grow in Atlanta

BusinessWeek online For a Q&A with Marc Fleury, go to www.businessweek.com

Is housing set to blow, or are there more gains ahead? Here's how to navigate an anxious market. **BY PETER COY**

Confused about the direction of the housing market? It's no wonder. You hear stories about sellers slashing listing prices to attract buyers, but home prices nationally have risen more than 10% over the past year. Inventories of unsold homes are on the rise, yet homebuilder Lennar Corp. just reported a 34% jump in earnings. And the much feared rise in 30-year mortgage rates seems to have stalled. ¶ In this muddled situation, what should you do, whether you're on the buyer's end of the seesaw or the seller's? Cut your price now or hold out for more? Rent or buy? Go for a bigger house or a smaller one? In the New York City suburb of Larchmont, N.Y., where prices are

off their peaks, confusion reigns. Says Realtor Carol Higgins: "Buyers are complaining that prices are astronomical, but sellers are still thinking they'll get what they saw their neighbors get last year."

¶ Let's be honest: No one can predict with certainty which way home prices will go in the next year or so. Over the past several years almost everyone who has tried to forecast the direction of the housing market has been wrong (though *BusinessWeek* Chief

Economist Michael Mandel takes a shot on page 76). ¶ We can, however, tell

you how to avoid some critical psychological and financial mistakes in

today's anxious markets. No matter how smart you are, it's easy to

fall into certain mental traps that can cost big bucks. Instead of

concentrating on the fundamentals, people tend to be

ruled by their feelings and the compulsion to compare

themselves with their neighbors. If your brother-

in-law made a killing in real estate, you're

determined to do the same. "So much of

what drives the housing market is

human interpersonal dynam-

ics," says Yale University

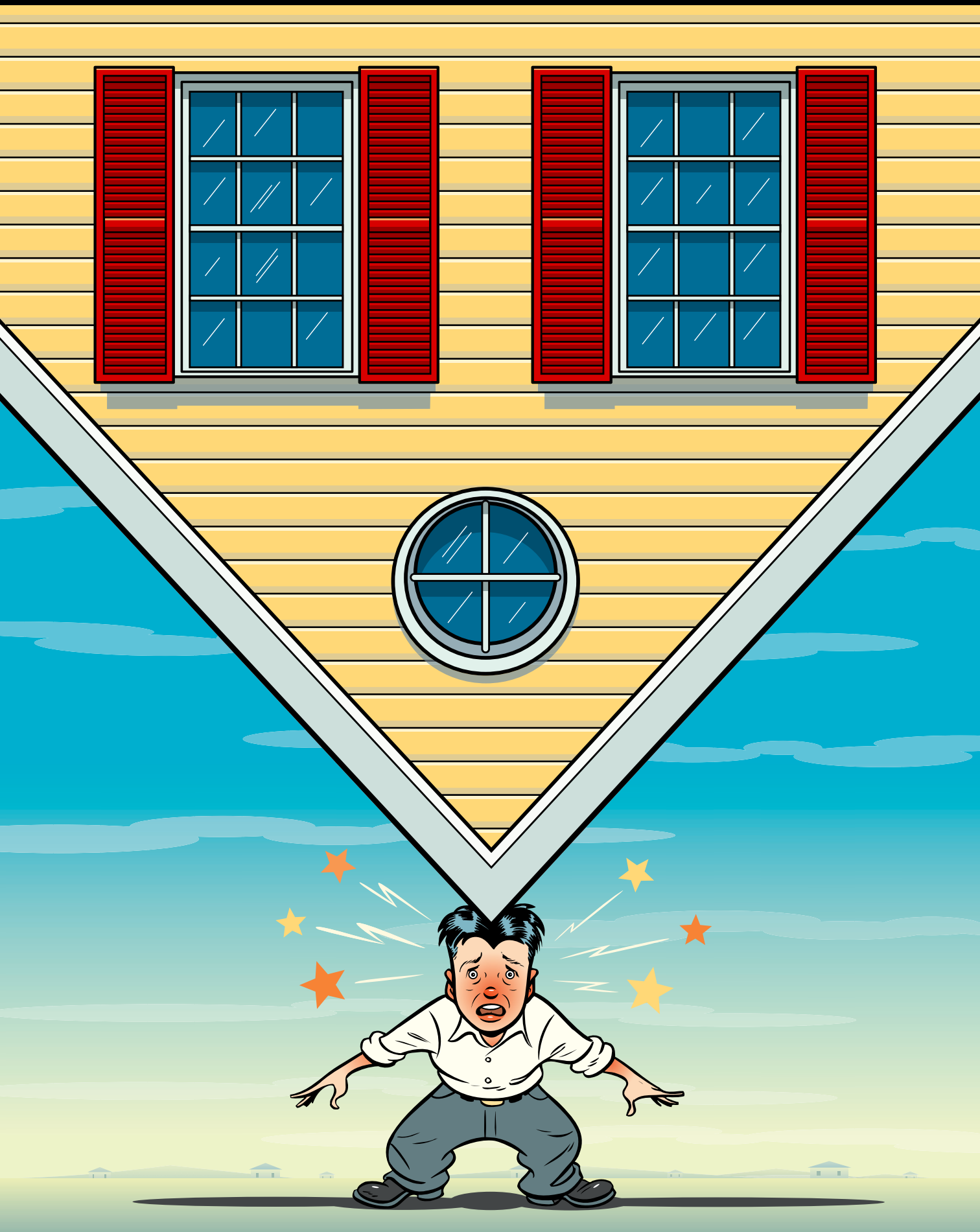
economist Robert J.

Shiller. ¶ What

follows

is

Buyer (and seller) Beware





LIVING IN THE PAST?

In a softening market, many sellers find it tough to bite the bullet and cut their asking price. JoAnn Watson and her husband are hanging tough in New Rochelle, N.Y.

a set of practical guidelines for navigating today's choppy and uncertain real estate markets. The suggestions come from behavioral economists, who study the kinds of erroneous decisions people tend to make repeatedly, as well as from hands-on real estate experts. In addition we'll tell you which cities are more vulnerable to a drop in prices and which are less at risk. (Go to businessweek.com for a free interactive table showing how 30 major metro areas stack up on 11 different housing-related measures.)

Contrarian Cool

A FIRST RULE OF THUMB is to avoid herd behavior, which is what lured a lot of people into overpriced houses in the first place. The expectation of rising prices became a self-fulfilling prophecy as office mates and in-laws tried to leapfrog each other. The prevailing mindset:

"You see people who aren't particularly talented, who aren't hard-working, who buy a house with nothing down, and they've been getting rich doing it. If they're getting richer, then you're falling behind," says Robert H. Frank, a Cornell University economist and author of *Luxury Fever*. Another attraction of herd behavior is safety in numbers. Millions of buyers can't all be wrong, can they?

Also, behavioral economists have discovered in laboratory experiments another attraction of herd behavior. Misery really does love company: People seem

Take a Hard Look At How You Think

You can make better choices by keeping in mind what behavioral economists have learned about the attitudes that often lead to poor decision-making

to worry less about losing a lot of money if they think everyone around them will suffer the same fate.

Still, the rewards of thinking independently can be high. Richard X. Bove, a financial services analyst at boutique investment bank Punk, Ziegel & Co., put on his green eyeshade and concluded that Florida real estate was overpriced. So earlier this year he bailed out. Bove sold his 5,600-square-foot St. Petersburg (Fla.) home for \$1.2 million, twice what he paid for it a decade ago. The plan was to rent while he waited out a housing decline. But Bove couldn't find a suitable rental, so he lowballed a four-bedroom house in Tampa and got it for \$740,000—30% below the asking price.

In a softening real estate market, one of the most dangerous mental mistakes is what behavioral economists call "loss aversion," which is the tendency to do dumb things to avoid, at all costs, recording a loss. Some sellers are so averse, they gamble

HERD BEHAVIOR In frothy markets, prices get out of line with fundamentals because of speculation and trend-following.

Solution: Before buying, assess what houses are really worth in the area where you want to live.

LOSS AVERSION People who bought high hate to sell low and take a loss. Some gamble recklessly that the market will rebound and bail them out. That just worsens the problem.

Solution: Cut your asking price and make the sale.

OVERCONFIDENCE It's human nature to think you know what you're doing. Reality, however, is often unkind.

Solution: Whether you're a buyer or a seller, make a plan that accounts for worst-case scenarios.

LOOKING BACKWARD Sellers' thinking tends to be six months behind the market. So when prices are rising, they set theirs too low, and when prices are falling, they set theirs too high.

Solution: Assess where the market is headed, not where it was.

HIS OWN MAN

Independent thinking has its rewards: Richard Bove sold high and bought low this year in Florida when he correctly calculated that the market was weakening



the market will bounce back rather than cut their prices.

Indeed, real estate agents often have a much clearer idea than sellers that demand has softened. “The hardest thing is to convince the sellers of the change in the market,” says Alfonsina Rechichi, an agent at Coldwell Banker Residential Brokerage in Katonah, N.Y. “There’s a sense of fear among brokers

that you sense at open houses,” says Saul Greenstein, a renter in Washington, D.C., who suspended his house search because prices were too high. “The self-confidence you saw a year ago has been replaced by fear and pandering.”

Even owners who stand to make a big profit on a sale often set the price too high. In this case the mental error isn’t loss aversion but outdated thinking. New research shows that sell-

ers set their listing price, in part, based on information six months to nine months old. That means if you don’t pay close attention, you will tend to underprice in a rising market and overprice in a falling one.

Stung on Both Ends

TWO SMART PEOPLE WHO JUST MIGHT be guilty of that in the New York City suburbs are Joe Watson, a neurosurgeon, and his wife, JoAnn, who has a PhD in genetics. In relocating from New Rochelle, N.Y., to McLean, Va., they planned to come out even by selling and buying at roughly the same price: \$1.2 million. Now they’re getting stung on both ends of the transaction. The Virginia house is costing them “significantly more” than \$1.2 million, and they can’t get what they want for their 1937 Tudor in New Rochelle. Says JoAnn: “We were advised by two brokers to price it initially at \$999,999, but my husband and I wanted to start at \$1.19 million because we thought we could get it.” Even after nudging the price down to \$1.09 million, though, there haven’t been any offers. JoAnn has taken to blaming the shoppers. “It’s a great house,” she complains. “Why doesn’t anyone realize it?”

The gravest danger of dragging your heels on price cuts in a sinking market is that you can “follow the market down,” never managing to sell because your price is always just a little too high, says Christopher J. Mayer, a Columbia Business School economist. He and David Genesove of Hebrew University in Jerusalem found that when prices were falling in Boston in the early 1990s, two-thirds of the houses that came on the market were eventually withdrawn without a sale.

In parts of the country where the market is still strong, a common sin continues to be overconfidence. Owners typically don’t seriously consider a wide enough range of potential housing market outcomes, including the possibility of a steep decline. That leads people to take more risks than they should.

Nordstrom Inc. managers Robert J. Gelb, 50, and his wife Cindy, 47, of Mercer Island, Wash., own the house they live in as well as two they bought for their children. Gelb says last

CASTLE THINKING Even when renting would be cheaper, many people insist on ownership because it satisfies a deep-seated need for security, as in “a man’s home is his castle.”

Solution: Take the step of at least looking at comparable rental prices before buying.

KEEPING UP WITH THE JONESES Obsession with status causes buyers to overspend on conspicuous displays—and nothing is more conspicuous than your house.

Solution: Realistically assess the future costs of ownership, especially if you have an adjustable-rate mortgage.

TANGIBILITY FALLACY Some homeowners have a false sense of assurance that property will keep its value better than investments like stocks and bonds.

Solution: Don’t put all of your money into real estate.

Data: BusinessWeek

PRESTON MACK/REDUX

Where Houses Are Affordable... Housing Opportunity Index* (higher is better)	DETROIT	ATLANTA	DALLAS	HOUSTON
	86%	76%	60%	57%
	Houses are cheap because many people have lost faith in the Motor City's future. Since 2000, employment has fallen 7%, and the number of annual construction permits is off 15%.	Its 28% price increase since 2000 is one of the lowest among major metro areas, according to the federal government. One negative: 41% of mortgages to buy homes last year were interest-only.	It's easy to build in Texas, so prices stay low. Construction permits have risen 37% since 2000 even though job growth has been flat. It's almost as cheap to buy as it is to rent.	Houston's economy has grown faster than Dallas', but so has construction. Houses in both Texas cities are actually undervalued, according to a Global Insight/National City Corp. index.

* National Association of Home Builders Housing Opportunity Index. This is the percentage of new and existing homes sold in the fourth quarter of 2005 that were affordable by a family earning

year's appreciation on the house his son occupies was greater than his son's salary at Nordstrom's. For the house they bought for their college-student daughter, they put down 3% and got a negative-amortization loan, which Gelb says makes it a better deal than renting her a dorm room. "Worst case is that I sell it for what I paid for it," he says. His take on housing is non-chalant: "Even if it is a bubble...it would be a slow leak. Maybe some people would say I'm naive, but I don't see a downside."

Optimist Gelb is well-off enough to take a slump in stride. Still, he might want to have a conversation with Linda R. Fink, 57, who manages a city park with a bicycle-racing track in Indianapolis. She knows all about slow leaks. Fink bought a house in November, 2000, for \$120,000. At the time, Fink says, she viewed the purchase as an investment and reassured herself that "if something happens five or six years down the road, I'll be O.K. I can sell it and get out."

Instead, Fink watched home prices in her neighborhood fall and fall. She bailed out in 2004 for \$92,000 in a "short sale," meaning the lender got the proceeds of the sale but not all it was owed. Says Fink: "It all just blew up on me."

Rent-vs.-buy decisions are a perfect example of what the housing market can learn from behavioral economics. If financial efficiency were all that mattered, more people would be renting

nice houses instead of buying them, even taking into account the home mortgage-interest deduction. But there's something comforting about owning the place where you lay your head on the pillow each night. "It's worked out so phenomenal," exults first-time buyer Obrey M. Minor, a 27-year-old special education teacher who bought his first house last year with his wife in the Houston suburb of Katy.

You can hear how much homeownership matters by talking



MEAGER OFFERS

You better believe home prices can fall. Linda Fink paid \$120,000 for a house in Indianapolis in 2000. Four years later she was able to get only \$92,000 for it

BOB HOWER/QUADRANT



...And Where They Aren't

MIAMI	NEW YORK	SAN DIEGO	LOS ANGELES
14%	6%	4%	2%
House prices in metro Miami rose 128% from 2000 to 2005, in part because of speculation. Loan Performance LLC says a high 17% of homes last year were bought as investments.	New York is chronically expensive, so its low affordability ranking doesn't prove that a crash is imminent. Land controls keep prices high. Issuance of construction permits has fallen 21% since 2000.	Monthly costs to rent a home in San Diego are just 38% of the costs to buy a similar property, according to Torto Wheaton Research. That's an indication that buyers are paying way above true value for houses.	According to the National Association of Home Builders, only 1 in 50 houses sold in L.A. late last year was affordable by a median-income family. Many people stretched to buy houses that are beyond their means.

a metro area's median income.

Data: National Association of Home Builders, Torto Wheaton Research, Labor Dept., Loan Performance LLC

to people like Annapolis (Md.) renter April McKinley, a health-care consultant who recently moved with her police officer husband from Pittsburgh to the Washington (D.C.) area and ran smack into a wall of high prices. "Here I am, a productive citizen, and I can't afford to own a piece of it," says McKinley.

Especially in upscale communities, social pressure to buy is intense. Jonathan Miller, CEO of real estate appraiser Miller Samuel Inc., recalls that when he and his family moved to upper-crust

Darien, Conn., 15 years ago and rented for a year, "we were absolutely second-class citizens. It was very unpleasant."

Call it "castle thinking"—the notion that a home is a fortress against a cruel world (table). And it's perfectly defensible. But in many markets the total monthly costs of renting are far below the total monthly costs of owning the same property—62% cheaper in San Diego, for example, according to Boston-based Torto Wheaton Research, a unit of property manager CB



MEMBER OF THE CLUB

Jonathan Miller says he and his wife felt like "second-class citizens" when they rented for a year before buying a home in upscale Darien, Conn., 15 years ago. "It was very unpleasant"

RICHARD FREDERICK/AURORA

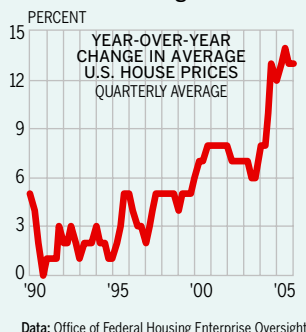
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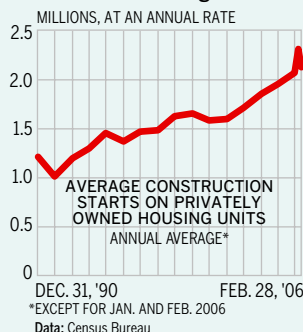


Is the Market Strengthening or Weakening?

Home prices are still rising fast...



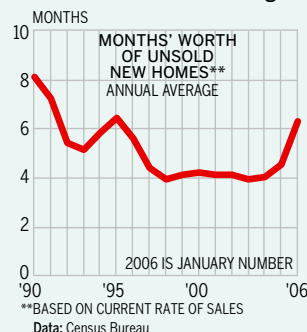
...and plenty of new homes are being started...



...but now interest rates are creeping up...



...and inventories of unsold homes are rising



Richard Ellis Group Inc. So you owe it to yourself to be aware that your castle thinking can be a costly predilection.

Neuroscientists have even discovered the place in your brain that makes you spend too much on a house. Far from behaving perfectly rationally, real people are pushed and pulled by signals emanating from below the neocortex—the primitive “lizard brain.” That may be why there are so many homes with empty marble foyers, faux Roman columns, dust-collecting Jacuzzis, and exotic drooping conifers on the lawn.

Manage Your Cravings

WHAT PEOPLE CAN DO is be aware of their human tendency toward status-seeking. Cornell's Frank suggests channeling the drive more productively. If getting your kids into a good school district is a priority, for example, try to satisfy your lust for status by buying a smallish house in a prime school district instead of a showplace in a worse one. “You have some choice,” says Frank. “There's room to do better.”

A foible that helps account for America's obsession with real estate is what you might call the tangibility fallacy. It's the all-too-human tendency to regard tangible things like houses as more stable and trustworthy than intangible ones like stocks and bonds. It's true that a house provides more comfort than a book entry in a stockbroker account. But that doesn't mean it's a better investment.

In fact, except for the past few years, house prices have risen only 1% or so faster than the rate of inflation. But just try telling that to Ron DeLucia of Jacksonville, Fla., who at the age of 68 is selling his current home and buying a bigger one across town, in part because he and his wife think a house is a more trustworthy asset than shares of stock. Says DeLucia: “We all went through the crash of the market. I lost \$150,000. You never get that money back. I think the stock market is going to go down. I'd rather put the money we have in hard assets like property.”

And finally, it's easy to lose your head over housing if your thinking isn't disciplined. To find your moorings, try to focus on the fundamental factors that determine value. On that score it's somewhat reassuring to realize that prices in the U.S., though high, are not out of line with other major countries. Finding properties that are exactly comparable is difficult. But in an unscientific survey, *BusinessWeek* correspondents rounded up listings for a few homes for sale around the world. There's a four-bedroom in Kleinmachnow, a pricey suburb of Berlin, going for \$525,000. In the upscale Golders Green neighborhood of London, 20 minutes from the city center, a four-bedroom house is on the market for \$1.56 million. And in Tokyo's Sugunami Ward, three bedrooms squeezed into a cozy 987 square feet go for \$566,000. These kinds of prices have a familiar ring.

Reading the Tea Leaves

WITHIN THE U.S., HOWEVER, prices in some housing markets do raise red flags. A good starting point is to look at the affordability of homes for ordinary families. By that measure greater Los Angeles was the worst in the nation in the fourth quarter of 2005. Only 2% of homes sold there were affordable by families earning the area's median income, according to the National Association of Home Builders. New York wasn't much better at 6%. Other expensive big cities included San Francisco at 7%, Miami at 14%, Boston at 24%, and Washington, D.C., at 27%. Tops in affordability among big cities were places like Dallas, with 60% of homes sold affordable by median-income families, San Antonio and Houston at 57%, and Chicago at 48%.

Of course, unaffordability is a chronic condition in cities like New York, so it's not necessarily evidence that a sharp correction is in the offing. Economists at Global Insight Inc. and National City Corp. deal with that by looking at whether metro areas have departed from their own historical trends in affordability. They conclude that in the fourth quarter, 42% of the top 299 metro markets were “extremely overvalued and at

Open the Doors, Look in the Closets

Study Your Local Conditions: This interactive table lets you analyze real estate in 30 metro areas.

Slide Show: What \$500,000 buys in each of 12 markets.

An Economist's View: Yale's Robert J. Shiller says there is a housing bubble.

The Story Behind the Story: For a podcast interview with Economics Editor Peter Coy by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.

Hot Property Blog: Our real estate writers weigh in at businessweek.com/the_thread/hotproperty/index.html

Staging Homes for Sale: For tips on how to make your home stand out, including hiring a professional stager, watch *BusinessWeek Weekend*. Check your local TV listings or view it at businessweekweekend.com.



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Real Estate Brokers Are Racing for Shelter

BY TIMOTHY J. MULLANEY

Barbara is a real estate agent in northern Virginia. She won't disclose her full name because she would be fired instantly if her bosses knew what she was doing: promising customers discounts on the gold-standard 6% commission charged by full-service brokers.

Most real estate companies require

home sales this year, to 6.7 million. Inventories of unsold existing homes are up 27% from early 2005, and the number of Realtors has risen 57% since 2001, to 1.2 million. Plus, Web-based startups are still pouring in, highlighted by the debuts of automated appraisal site Zillow.com and Redfin, a Seattle discount broker.

The combination of slumping sales, a glut of agents, and an influx of aggressive rivals

30% jump in the number of homes on the local market by offering free warranties worth \$400 and a one-year reduction in the mortgage's interest rate, says general manager Barbara Jandric. Iowa Realty in Des Moines is letting consumers choose a limited-service, flat-fee plan that costs \$3,795, about 2% of the average local house. "We'd like to protect our fee, but we need to separate ourselves," Jandric says.

Other companies are investing in technology. Cendant Corp. is laying out \$50 million to upgrade its online presence.

THE LOW ROAD
More home sellers are moving to cut-rate firms such as 3% Foxtons

Others are working with referral services such as newcomer Legacy or IAC/InterActiveCorp's RealEstate.com

and LendingTree. These businesses take a split of agents' commissions and give consumers rebates or gift cards worth up to \$2,000. "February was our first down month in seven years," says Stephen W. Baird, president of Baird & Warner in Chicago. "Anything that moves and says it has leads, we'll try it."

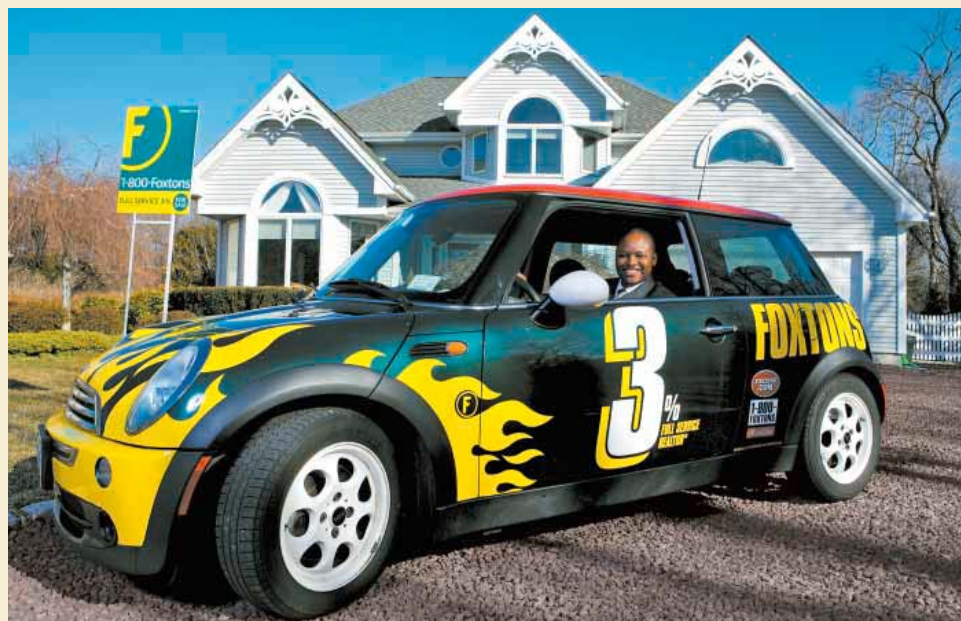
And the 6% industry-standard commission is under fresh pressure, as Barbara can attest. The national average has fallen to 5.1% and could dip below 5%, industry consultant Steve Murray says. Consumers persuade full-service agents to come down or hire discounters such as New York's Foxtons, which charges 3%. "In high-end markets, 4.5% is the new

6%," says Murray.

Given the pressures, brokerage profits are sluggish. Cendant, which franchises Coldwell Banker and Century 21 and directly owns 1,100 offices, says 2006 pretax earnings will be flat. Upstarts are struggling too: Web discounter ZipRealty Inc. and agent-referral service HouseValues Inc. saw shares pummeled when they said earnings would be weaker than predicted. That buoys the hopes of full-price players. "In a moderating market consumers choose the firms that are the best marketers," Cendant Real Estate CEO Richard A. Smith argues.

Now that consumers hold the power, agents are more willing to negotiate for business. Just as last year sellers charged what the market would bear, this year buyers can push hard to get a deal.

—With Dean Foust in Atlanta



agents to get permission to cut a commission, or, like Barbara's employer, strictly forbid it. But as the housing market grows weaker on both coasts and in regions in between, more and more agents are willing to accept lower fees to drum up sales. Barbara is getting clients from the two-month-old referral service Realty Legacy Group. She charges a full commission in all the official sales documents but later secretly rebates at least 1.5% of the house price in the form of a personal check to the client. That hurts, but it has generated 20 leads in a few weeks. "Legacy allows you to negotiate the commission, but in a discreet way," she says. "I think it's brilliant."

Brilliant ploys are essential in today's brutally competitive market. After a five-year boom, the National Association of Realtors forecasts a 5.7% decline in existing-

has traditional real estate brokers scrambling to devise new ways to move property. They're not just cutting commissions or prices. Many are adding services, too. Edina Realty, the biggest brokerage in Minnesota, is fighting a

Perception Vs. Reality

Real estate brokers report sustained pressure on traditional commissions in a softer, more competitive market

QUOTED COMMISSION

6%

AVERAGE COMMISSION

5.1%

Data: REAL Trends Inc.

risk for a price correction.” Florida and California dominate this historically adjusted list. Boston and New York look more reasonable by this measure, and San Francisco appears a bit less bubbly. Texas still comes out looking cheap.

Yet another way to identify a problem area is to compare rents to sales prices. The idea here is that if people’s monthly payments to own a house are much higher than what they would spend to rent the same place, tax considerations included, then they must be banking on prices going up so they can sell for a profit someday. That leaves them exposed if

prices don’t rise. By this measure, San Diego is one of the frothiest areas of the country. But Tampa, Orlando, and New York, which come out as expensive by some other measures, aren’t so costly by this one.

This year millions of American households will buy a home. The process will always be lengthy and a big deal. But whether you are a buyer or seller, you don’t have to feel quite so lost. ■

—With Toddi Gutner and Timothy J. Mullaney in New York, Christopher Palmeri in Los Angeles, and bureau reports

COMMENTARY

BY MICHAEL MANDEL

Think of It As a Return to Normal

I see a slow-motion drop over several years—with some areas getting slammed

IS A HOUSING BUST on the way? The question has a familiar ring. Since 2001 economists and journalists have with great regularity predicted an imminent crash in real estate prices, including a 2004 story in *The New York Times* with the headline “The Housing Bust: It Won’t Be Pretty.” Despite the predictions, however, home prices continued to rise, clocking in double-digit gains over the past two years.

Now it’s my turn to take a whack at the housing piñata. I believe there’s a good chance that real estate will follow a similar path as the stock and tech markets: a long boom followed by a decline of several years that gradually brings back values to the long-term trend.

If the housing market repeats this pattern, the result would be a slow-motion decline of 10% or so in national home prices, the equivalent of giving back a year or two of gains. Some regions, of course, would be hammered. A drop of this magnitude would be well worthy of the term “bust.”

Especially hard hit will be recent buyers with a lot of debt as the drop in prices sends them, sadly, into the land of negative equity. Other homeowners would feel excruciating financial and psychological distress as paper gains melted away. Even the real winners—people who formerly couldn’t afford to purchase—will feel anxious and paralyzed as home values fall.

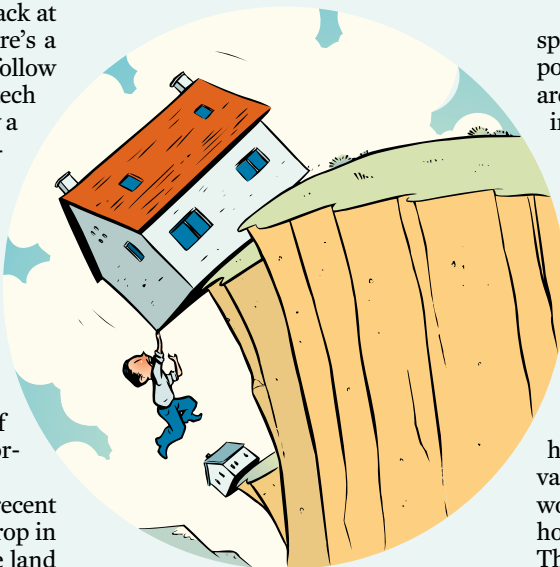
Still, it’s better to think of the hous-

ing bust as a return to normal rather than the end of the world. That’s the lesson of the stock and tech crashes. For one thing, after a decade of boom, bust, and recovery, the Standard & Poor’s 500-stock index today is 83% higher, adjusted for inflation, than it was in 1995. Thus, stock prices rose at an annual real rate of 6.3% over the past decade, just below the rate of the previous 15 years.

Or look at information technology spending by businesses. Despite the post-2000 tech bust, such purchases are 50% higher than in 1995, taking into account economywide inflation. That translates into an annual average sales gain of 4.3%, roughly the same growth rate as 1985 to 1995 and somewhat slower than the 15-year average.

If housing were to return to its long-term trendline, what would that mean for prices? Over the past five years home prices, adjusted for inflation, have risen at an extraordinary 6.8% annually, far higher than the historical 1%. To get values back on the long-term path would require a 20% drop in national home prices by 2010 in real terms. That’s equivalent to a roughly 10% drop in the actual number of dollars buyers have to shell out.

A housing bust is hardly a sure thing. Asset markets—and your home is certainly an asset—are notoriously unpredictable. But whether you are a buyer or seller, it’s worth taking the possibility seriously.



Real estate may go down the same path stocks and tech did: Long-term net gain

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Science For A Better Life



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**EDITED BY
ARLENE WEINTRAUB**

INNOVATIONS

Of salt and spices

▶▶ Slashing salt consumption can sometimes lower high blood pressure, but scientists from the **George Institute for International Health** in Sydney have gone a step further. They came up with a salt substitute that can reduce hypertension more effectively than most dietary changes, and as well as some antihypertensive drugs. Plus, their blend of sodium chloride, potassium chloride, and magnesium sulfate actually tasted like plain old table salt,

i.e., sodium chloride, to most participants in a yearlong, randomized trial. These participants should know: They

are residents of northern China, where diets contain two to three times as much salt as those of other world populations.

▶▶ A key to pain relief may be sitting on your hot dog bun. A team led by **Yale School of Medicine** researcher Sven-Eric Jordt isolated a nerve receptor in mice that responds to the compounds found in sinus-clearing mustard oil and garlic. Reporting in the Mar. 23 *Cell*, the team says the receptor, dubbed TRPA1, responds to a natural inflammatory agent that stimulates pain-sensing neurons. It also reacts to lung irritants such as vehicle exhaust, tobacco smoke, and the byproducts of some chemotherapies. Identifying the receptor that responds to such assaults may be the first step toward a pain-relief drug.

—Catherine Arnst



NANOTECHNOLOGY

BUILDING BRIDGES IN A DISCONNECTED BRAIN

SCIENTISTS AT Massachusetts Institute of Technology used nanotechnology to partially restore sight to blind hamsters. Severed connections in the rodents' brains caused the animals to lose their sight. The MIT process enabled brain cells to recreate some broken connections. This could offer hope to victims of stroke, who can suffer speech loss and other impairments.

The MIT team injected the hamsters' brains with a solution containing protein

fragments called peptides. The peptides assembled themselves into thin scaffolds made of 99% water and 1% protein. Brain cells then sent branch-like extensions called axons across the scaffolds, reestablishing neural contact. Within six weeks, partial sight was restored.

The scientists believe such a process could one day help stroke patients regain their ability to speak, and might restore some movement in patients with spinal cord injuries.

CLEANER WATER

PLANTS WITH A HEARTY APPETITE FOR HEAVY METAL

EVEN AS FACTORIES get cleaner, the legacy of a century's worth of industrial effluvia persists. Across the U.S., canals, rivers, and lakes are tainted with traces of toxic heavy metals sent down the drain years ago. Once settled into sediment, such waste can bind with silt, making it difficult and costly to remove.

Now researchers at Ohio State University have developed a new technique for cleaning the silt that uses a combination of ultrasound and algae. First, focused beams of ultrasound vibrate the metals free from the sediment. Next, the liberated metals are passed through tiny algal buds that are bred to trap metals such as



ENERGY

FUSION: FINALLY FEASIBLE?

FOR DECADES, researchers have been working to harness fusion, the type of nuclear reaction burning inside the sun, for electricity. Fusion produces fewer toxic leftovers than current fission reactors, but it has proven to be a difficult and expensive target. Sandia National Laboratories may have eased the task by inadvertently generating temperatures 100 times hotter than the inside of our sun.

As part of a program to examine aging nuclear

weapons, the lab was generating X-rays by zapping spools of wire with 20 million amps of electricity. When the scientists changed from tungsten to thicker bundles of steel wire, they exceeded 2 billion degrees Kelvin, which is equivalent to 3.6 billion degrees Fahrenheit.

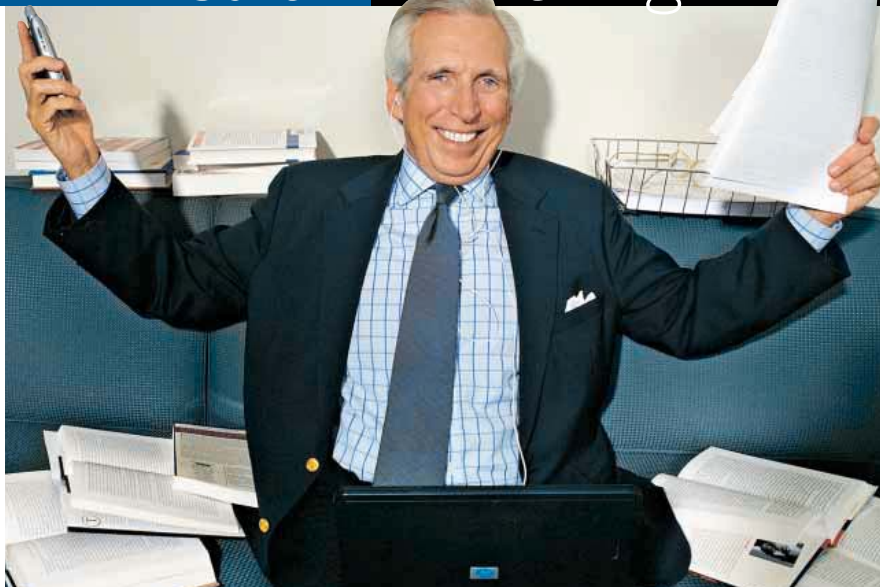
There are some skeptics: William Parkins, the late chief scientist at the company now known as Rockwell Automation, wrote in a paper (published posthumously in March) that fusion plants would be far too expensive to be practical. But the Sandia discovery could yield strategies for building small, less expensive fusion reactors.

—Aaron Pressman

cadmium, copper, mercury, and zinc.

In the lab, OSU's process captured 30% of the mercury within minutes and netted up to 60% during longer exposures. Presented at a meeting of the American Chemical Society in March, the findings suggest that the system could be easily fitted to boats to dredge and clean industrial sediments more economically than is now possible.

—Adam Aston



Getting Out Of a Bind

Publishers are testing multichannel delivery to offer readers more choices

BY TOM LOWRY

AT THE TINY TOME ON the Range bookstore in Las Vegas, N.M., nothing gets manager Jillian Rael more steamed than when customers tell her they won't wait a week for a book to arrive on order. They would rather drive the hour or so to Santa Fe to buy it sooner at a chain store. The 10-year-old Tome's location in the foothills of the Sangre de Cristo Mountains makes it tough to restock quickly. On top of that, to fill orders, Rael says she often has to buy more books than she needs to meet publishers' quotas, only to send them back. "The system is pretty darn inefficient," fumes Rael. "It hurts us and the customers."

Now the two-decade-old concept of just-in-time inventory is catching up to the antiquated book biz. A new scheme set to be announced in early April, dubbed the Caravan Project, calls for books to be delivered simultaneously in five formats—hardcover, digital, audio, print-on-demand, and by chapter. The

initiative is the brainchild of Peter Osnos, a publishing veteran and founder of non-fiction imprint PublicAffairs. He figures that publishing's ancient habits are holding it back, keeping it "some sort of relic to Gutenberg." Following the lead of Hollywood mavericks such as billionaire producer and theater owner Mark Cuban, who advocates releasing movies on the same day to theaters, on DVDs, and to TV, Osnos argues that readers should be able to read books when and how they

OSNOS "We just needed a coherent approach. We have one now"

want. By creating a menu of choices for consumers (table), the industry could go a long way toward making the distribution of its books more cost-efficient. "The technology is here," says Osnos, 62, a onetime foreign correspondent at *The Washington Post*. "We just needed a coherent approach. We have one now."

NAPSTER NIGHTMARES

SIX NONPROFIT publishers (three are university presses), No. 2 retailer Borders Group, a few independent bookstores (not Tome on the Range, however), and publishing wholesale powerhouse Ingram Industries are participating in Caravan. The first step: Publish 24 books initially across the five formats in early 2007. Funded by a \$250,000 MacArthur Foundation grant, the project is relatively small, Osnos admits. "But we don't have to be big," he adds. "We just have to show that this model is irresistible to everyone in the chain—to authors, publishers, and booksellers. We can't continue to print 10 books to sell 6." Adds Tom Dwyer, director for adult trade books at Borders: "We never want to underestimate the public's desire for information and choices. This lets us put our foot in the water."

But talk of going this far this fast unnerves publishers. Publishing giants such as Random House and HarperCollins Publishers already feel huge pressure to sell digital versions of their books, especially from Google and Yahoo!, which want to deliver books the same way. They argue they are moving in the right direction. Audio books, while expensive to produce, have been around for years, they say, and the quality of print-on-demand books has improved. Just the same, "they are terrified of being Napsterized," says Al Greco, senior researcher for the nonprofit trade outfit Book Industry Study Group.

Books: How Do You Want Them?

A new business plan calls for books to be delivered simultaneously in five formats. Here is the menu:

Data: The Caravan Project

HARDCOVER The tried and true. Readers have been doing it this way for 600 years.

DIGITAL For sale online and for e-book readers.

AUDIO New software enables text to be converted to a simulated voice, lowering production costs and allowing for more audio books.

PRINT-ON-DEMAND A store doesn't have your favorite best-seller on its shelves? No problem. Go to the clerk and have it printed out from kiosks that will eventually be on the premises.

PIECEMEAL Allows you to buy chapters or portions of the book, either by print-on-demand or online.

“So turning over their books to electronic files for use in print-on-demand may not be viable because of the risks.”

The all-at-once approach is also scaring some authors, who prefer the release of just the hardcover first. “At the risk of sounding vulgar, I make more royalties when a book is sold in hardback,” says Simon Winchester, whose latest work, *A Crack in the Edge of the World: America and the Great California Earthquake of 1906*, was published in October. Still in hardcover, it could see a surge in sales from publicity surrounding the disaster’s centennial in April. Coming out in many formats on the same day, Winchester says, is akin to “a film going straight to video.”

But the industry could see as much as a 15% increase in net sales under the Caravan Project model, Osnos projects.

Industry sales could rise 15%, Osnos predicts

Sales of all books in the U.S. last year were \$25 billion, according to the Association of American Publishers, up 10% from 2004. Not only would publishers see a bump from additional sales of more audio and digital offerings,

Osnos figures, but print-on-demand would help cut down on large returns of inventory. Last year 33% of adult hardcovers were returned by stores to publishers, says the Book Industry Study Group. Publishers have never been good at gauging demand, and returns—known in the industry as “rotting fruit”—have been a big drain on profits.

Having the ability to quickly print and deliver books on demand, eventually using in-store kiosks, could help tremendously. Osnos says that could be invaluable to a seller, especially after a wave of publicity ratchets up demand. Today a book can be printed and glued together in under 10 minutes and shipped out in 24 hours, says J. Kirby Best, president and CEO of Lightning Source Inc., the print-on-demand unit of Ingram.

Making books available in more ways could even help ease the industry’s other chronic headache—booming used-book sales, which, at more than \$2 billion a year, deliver no royalties to publishers and authors. “There is no reason for you to go into a store,” says Osnos, “ask for a book, and not leave with it.” ■

It’s a Little Easier Being Green

Consumers and companies are giving alternative energy a boost with “green tags”

BY HEATHER GREEN

MARTIN HUGHES IS not your typical hybrid-driving, clean-energy fanatic. Hughes and his wife, both longtime oil-industry veterans, zoom around Houston in no-compromise vehicles. His, a Nissan Xterra SUV. Hers, a zippy Volkswagen Passat.

Yet when Hughes heard last year about an environmental startup called TerraPass Inc., he was intrigued. The Menlo Park (Calif.) company sells “green tags,” which cost up to \$80 a year and which are designed to offset the emissions a car spews into the air during that period. After taking a small cut of each sale, TerraPass pools its members’ fees and invests them in clean energy production, including wind power. Hughes checked out the service online last August and then forked over \$129 for two TerraPass windshield decals. “I was impressed,” he says. “It’s a for-profit product that allows you to exercise your conscience.”

TerraPass is channeling the good intentions of individual consumers concerned about carbon emissions, which are linked with global warming. U.S. companies are also adopting the certifi-

cates, in part because they wish to cater to this growing, green constituency. But the tags, which are now America’s fastest-growing alternative-energy product, aren’t simply a marketing vehicle. U.S. businesses have watched Europe and Japan adopt tough regulations on carbon emissions and say the tags could help them prepare for similar developments in the U.S.

Starbucks Corp. has been a leader in the green-tag movement, mainly because renewable power is still hard to come by. Last year, Starbucks made a pledge to buy 20% of the annual electric power for its North American stores—about 150 million kilowatt hours—from renewable sources. But no single wind farm can service all 8,400 of its U.S. coffee shops. In fact, many Starbucks have no means of hooking up to any renewable power producer.

So Starbucks stores continue to consume power as usual, but the company passes an extra payment of less than half a cent per kwh to a middleman called 3 Phases Energy Services in San Francisco. 3 Phases redistributes funds to 40 wind farms across the country, then issues a certificate. With this subsidy, the farms cut the price of their power and boost sales to local cus-

Combating Climate Change

Windmills and solar farms generate earth-friendly electricity, but they can’t service all the households and companies that might want their power. Also, their costs are often higher, so they can’t easily compete with coal, natural gas, or other fuels that release CO₂. Businesses and consumers can help level the playing field by purchasing “green certificates.” Here’s how they work:



CLEAR CONSCIENCE
Hughes (with son, Finn) bought TerraPass tags for both family cars

states have adopted requirements that power companies replace a portion of the energy they sell with renewable power. California is committed to a goal of 20% by 2017, and New York has to hit 25% by 2013. In many cases, green tags offer the easiest path to meet the new minimums.

For retail operations such as Starbucks and Whole Foods, the tags help attract a green clientele. For industrial companies such as DuPont, Staples, and J&J, green tags are also a way to meet, or anticipate, regulations. With the carbon-restricting rules of the Kyoto Accord in effect in Europe, Canada, and Japan, many such companies are trying to align their U.S. operations with global practices. "We need to understand how to do business as a company in a carbon-constrained environment," says Mark Buckley, vice-president for environmental affairs at Staples Inc., which aims to reduce its emissions by 7% by 2010. Meanwhile, a clutch of state-backed and nonprofit auditors, such as Green-e in San Francisco, is trying to standardize how tags are measured and tracked.

While many companies are just beginning to experiment with green certificates, individuals are using them to offset the power consumed in everything from cross-country flights to wedding receptions and ski trips. At Mt. Hood Meadows Ski Resort, an hour east of Portland, Ore., 18,000 skiers purchased green tags this year. One was Allen Engle, an electrical engineer in Bend, Ore. He buys a \$2 green tag along with his \$48 lift ticket, to compensate for the power consumed on his day trip to the slopes. "To get any new technology started, you need incentives, like tax incentives," says Engle. For many companies and consumers, tags are an acceptable short-term cost. ■

tomers. The net effect: Nationwide, an amount of power equal to Starbucks' purchase is shifted to wind and away from conventional "dirty" sources.

A host of companies is now using this clever type of transaction to meet renewable energy targets, slash emissions, and make their brands stand out. Whole Foods Market Inc., based in Austin, Tex., turned to certificates in January, when it decided to offset 100% of its energy consumption with renewables. Whole Foods quickly became the biggest corporate buyer of such tags in the U.S. Safeway, Liz Claiborne, and HSBC have also made major pledges in the past year. "We'll see more and more reliance on [tags]" in coming months, says Blair Swezey, a

policy adviser at the U.S. National Renewable Energy Laboratory in Golden, Colo.

Green tags come with a cost. For big purchases, the certificates can tack an extra 0.5% to 8% onto an energy bill. "It's not a financial hardship, but it is an incremental amount of money that's not required," says Steve McDougal, senior manager of business development at 3 Phases, which also supplies green tags to Johnson & Johnson and IBM. Still, the premium that most companies pay for green tags works out to far less than they would pay to buy renewable power directly from a patchwork of suppliers, McDougal says.

Now utilities are snapping up green tags as they scramble to meet new renewable energy regulations. To date, 23

(TOP) PHOTOGRAPH BY WYATT MCSPADDEN

1 Last December, Starbucks promised to purchase 20% of its power, about 150 million kilowatt hours (kwh) per year, from renewable sources. Yet many of its stores are not hooked up to wind or solar farms. So Starbucks buys regular dirty power for 8,400 locations, then pays an extra fee to a middleman to help offset the emissions.



2 The middleman, 3 Phases Energy, has contracts with wind projects across the U.S. 3 Phases transfers Starbucks' money to these wind farms, which use the subsidy to lower their own prices so that they can sell power to nearby customers at competitive rates. This encourages consumption of green power equal to the 20% target that Starbucks has set.

3 A nonprofit called Green-e watches over the deal, checking details such as the payment terms. This guarantees that the middleman and windmills don't accept additional subsidies for the same wind power. 3 Phases issues Starbucks a "green certificate" confirming the transaction.





HP Wants Your Old PCs Back

It's pushing states to force recycling of TVs, computers, and other e-gear. Here's why

BY LORRAINE WOELLERT

A FEW YEARS AGO, when environmentalists in Washington State began agitating to rid local dumps of toxic old computers and televisions, they found an unexpected ally: Hewlett-Packard Co. Teaming up with greens and retailers, HP took on IBM, Apple Computer, and several major TV manufacturers, which were resisting recycling programs because of the costs.

Aided by HP's energetic lobbying, the greens persuaded state lawmakers to adopt a landmark program that forces electronics companies to foot the bill for recycling their old equipment. "This bill puts our market-based economy to work for the environment," said Washington Governor Christine O. Gregoire as she signed the plan into law on Mar. 24.

The movement to recycle electronic refuse, or "e-waste," is spreading across the nation, and so is HP's clout. The company helped the greens win a big battle in Maine

in 2004 when the state passed the nation's first e-waste "take-back" law. Washington followed suit. Now, Minnesota and New Jersey are preparing to act, and 19 other states are weighing legislation. Activists hope to banish high-tech junk from landfills and scrub the nation's air and water of lead, chromium, mercury, and other toxins prevalent in digital debris.

HP's efforts have made it the darling of environmentalists. They say take-back laws are more effective at getting digital junk recycled than point-of-sale fees, which tax consumer electronics products to fund state-run recycling programs. They're also pleased because effective programs in the U.S. reduce the likelihood that the products will be shipped to less developed countries and disassembled under unsafe conditions.

But HP's agenda isn't entirely altruistic. Take-back laws play to the company's strategic strengths. For decades the computer maker has invested in recycling infrastructure, a move that has lowered its production costs, given it a leg up in the secondary market for equipment, and al-

BIG BUSINESS
HP recycled more than 70,000 tons of product in 2005

PHOTOGRAPHS BY PETER DASILVA

lowed it to build a customer service out of “asset management,” which includes protection of data that might remain on discarded gear.

In 2005, HP recycled more than 70,000 tons of product, the equivalent of about 10% of company sales and a 15% increase from the year before. And it collected more than 2.5 million units (in excess of 25,000 tons) of hardware to be refurbished for resale or donation.

No other electronics maker has a resale business on this scale. But the others may soon wish to emulate HP. “We see legislation coming,” says David Lear, HP’s vice-president for corporate, social, and environmental responsibility. “A lot of companies haven’t stepped up to the plate.... If we do this right, it becomes an advantage to us.”

For television makers, on the other hand, take-back laws are terrifying. Following the lead of PC makers, they’re pushing consumers to replace their bulky television sets with flat-screen models, many of them primed for high-definition viewing. As a result, in the next three years, Americans are expected to throw out more than 550 million analog TV sets and computer monitors that contain thousands of tons of lead. The last thing these companies want are coast-to-coast take-back laws.

More than a dozen consumer electronics companies, including Panasonic, Sony, and Philips, have formed a group called the Manufacturers Coalition for Responsible Recycling. Backed by IBM, Canon and Apple, they have dispatched lobbyists to statehouses across the nation, pushing bills that mirror California’s somewhat weak recycling program. Instead of forcing manufacturers to take back waste, they would impose a levy of up to \$10 on sales of products to help states cover recycling costs without burdening equipment makers.

The e-waste skirmish is part of an important new front in global environmentalism called product stewardship. Proponents argue that a company’s responsibility for what it sells should include collection and disassembly at the end of the product’s life cycle. As a slogan, product stewardship has been around since the Earth Days of the 1970s, but it is now a serious force in the auto and electronics sectors of Japan and Europe. The movement is likely to broad-

en in the U.S. as well. Several states are strong-arming auto makers into using less toxic parts, persuading thermostat manufacturers to fund bounties for the return of old mercury-laden devices, and pushing pharmaceutical giants to redesign packaging to reduce waste and accept unused medications for disposal.

But manufacturers have many concerns, including the fact that take-back laws such as Maine’s allocate costs based on the weight of the junk consumers re-

machines bearing its logo. “They’re really discriminating against legacy manufacturers,” says coalition spokesman David A. Thompson, director of Panasonic Corp.’s Corporate Environmental Dept. “New market entrants have no waste stream. They’re getting a free ride in Maine and Washington.”

BRUISED APPLE

ENVIRONMENTALISTS’ biggest disappointment has been Apple Computer Inc.

The company’s progressive image, loyal customers, and retail network make it a natural for a take-back program. Yet Apple has fought such programs, and it lags behind HP and Dell Inc. in voluntary recycling. During Maine’s legislative fight, “they were doing more than any other manufacturer to fight the bill,” says Jon Hinck, staff attorney for Maine’s Natural Resources Council.

When shareholders at last year’s annual meeting hit Apple over the Maine bill, CEO Steven P. Jobs publicly dismissed the gripe with a barnyard profanity. This year, green groups have put a resolution on the agenda of the Apr. 27 shareholder meeting that directs Apple to study how to boost recycling. “They are laggards in a number of ways on the issue of e-waste. It’s come to the point where we need to have the company confronted,” says Conrad MacKerron, director of the corporate social responsibility program at As You Sow Foundation, a green advocacy group that pushed the resolution.

Apple says critics ignore the company’s efforts to use recyclable and clean materials in its products. It has cut lead use and says that, by weight, 90% of Apple computers can be recycled. Their sleek designs and spare packaging also mean less waste, says Chief Operating Officer Timothy D. Cook. “It’s important to look at the whole of the process,” he says, “not just one part.” Cook also argues that take-back programs

overlook a key fact: “Recycling is a responsibility of the person who makes the product, the people who use the product, the people who sell the product, and the government.”

If Apple hopes to catch up with HP, it might have to think harder about the first part of that sentence. ■



Get the **Lead** Out

With America awash in e-waste, including discarded laptops, TVs, computer monitors, and other parts, there is a growing call for “take-back” laws

CALIFORNIA	Levies a sales tax of \$6 to \$10 on such devices to help fund recycling programs
MAINE	Bills manufacturers to cover recycling costs
MARYLAND	Asks manufacturers to chip in on a five-year recycling pilot program
WASHINGTON	Will offer manufacturers a choice: Pay for recycling or take back used products

Data: Computer TakeBack Campaign

turn. Consider the implications for big picture tubes: A company like LG Electronics, which owns the Zenith brand, could end up being responsible for heaps of old Zenith TVs, even though LG’s market share is relatively small. And IBM, which has abandoned the PC market, might still be forced to recycle millions of



NBTA's Focus on Business Travel 2006

Business travel is on the upswing, and so are travel costs. According to the National Business Travel Association's (NBTA) 2006 Business Travel Overview and Cost Forecast, domestic airfares are expected to rise six percent this year, hotel prices are projected to jump nine percent, and car rental prices are predicted to climb five percent. "These cost increases, along with growth in the number of travelers and trips per year, puts the spotlight firmly on travel procurement," said NBTA president and CEO Suzanne Fletcher.

So how are America's most progressive companies sourcing travel, implementing spending controls, and leveraging purchasing power? According to the NBTA, they are following these best practices:

Designate a travel manager. Whether this manager reports to finance, procurement or elsewhere, a subject-matter expert skilled at negotiations, communications and data management can apply industry-specific expertise to strategic sourcing of travel.

Monitor and analyze travel expenditures at an enterprise-wide level. Travel is typically a corporation's second or third largest controllable expense. Understanding patterns – including frequently traveled routes, how far in advance travelers make reservations, seasonal variations, and regional variations – is the first step in spend control. "Many companies are taking a hard look at all areas of travel spend," says Charles Franklin, manager of corporate services, American Honda Motor Company, Inc. "They're creating cost-effective, enterprise-wide approaches to meetings and moving transient travelers to lower-cost or higher-value choices.

These efforts may include switching to a different tier or brand of hotel, using secondary airports, or in some markets, traveling by rail rather than air."

Some companies are also taking advantage of new opportunities to collect

frequency-program points for employees' business flights. The **British Airways On Business** program, for example, allows companies to earn points redeemable for upgrades, reward flights and hotel stays. To make this option more attractive to road warriors, travelers who are Executive Club members also benefit by earning British Airways Miles for personal use.

Visit www.britishairways.com.

Enforce travel policy. Travel guidelines cover everything from how reservations are made (online or with a travel agent) to when travelers can fly Business Class (on a flight over five hours or if the traveler is at director level or above) to limits on business entertaining.

July Conference to Focus on Best Practices in Business Travel Management



The National Business Travel Association's (NBTA) International Convention & Exposition offers opportunities for attendees to learn more about the travel management practices outlined in this section, as well as other best practices and developing industry trends.

More than 5,000 corporate travel professionals from more than 30 nations gather each year for this leading industry event, which features:

- A trade show with more than 400 exhibitors
- A Technology Pavilion showcasing the latest developments in travel management technology
- A variety of opportunities to network with peers
- World-class speakers
- More than 50 seminars covering best practices and the latest developments in business travel
- Several levels of professional development offered in pre-convention sessions

For information on how your company can take part in **NBTA's 2006 International Convention & Exposition, in Chicago, July 16-19, see www.nbta.org**



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Yet no policy is effective unless it's communicated and enforced. Best-practice companies communicate regularly through multiple channels to teach travelers and travel arrangers about the travel program and the importance of compliance. Many travel managers also use electronic filters to identify out-of-policy requests at point-of-sale, requiring a manager's approval of such bookings before reservations are finalized. Regular audits, also a best practice, identify problems and new savings opportunities.

Best-practice companies also adjust policy over time, allowing the program to respond to trends in the marketplace or changes at the company. "A new route launched by a low-cost carrier flying your company's frequently used city-pairs would prompt you to examine existing airline contracts," says Sally Abella, CCTE, director of corporate travel, Harman International Industries, Inc. Likewise, she said, a merger or acquisition may combine a loosely-managed travel program with a highly controlled one, requiring a policy evaluation.

Globalize a corporate card program. By channeling all T&E charges through a small number of corporate cards, spend information can be captured no matter where travelers are based or how they book travel.

Card companies offer sophisticated spend analytics tools that allow companies

to aggregate data in meaningful ways. This information is of vital interest not just to your company, but also to vendors willing to provide significant value for corporate clients in exchange for volume or market share commitments.

There are other benefits to card

productivity. On long-haul flights a traveler's comfort crosses both categories, ensuring a pleasant trip and a more productive employee. Seats that convert into flat beds are a distinct competitive advantage for global airlines such as British Airways and Malaysia Airlines.



Best-practice companies also adjust policy over time, allowing the program to respond to trends in the marketplace or changes at the company.

programs. Some offer financial incentives once a certain spending threshold is reached. Most offer supplemental insurance for car renters. Companies can set spending limits, or even issue an event-specific card.

Negotiate corporate travel contracts and discounts. "One of the travel manager's most important strategic functions is to negotiate agreements with airlines, hotels, car rental companies and travel agencies," said NBTAs Fletcher. The agreements should be designed to meet both corporate goals – safety, cost-efficiency, effective employees – and traveler needs – comfort and

Designers of British Airways' Club World product clearly have traveler productivity at top of mind. Passengers are given the option of eating dinner in the departure lounge so they can go to sleep immediately after boarding; once at Heathrow, there's a spacious, modern lounge-cum-spa, where travelers can shower, relax, get their shoes shined and clothes pressed, check e-mails, and eat a leisurely breakfast before heading off to meetings.

Automate the front and the back end. By having travelers book their own travel using an automated, enterprise-wide booking tool, companies can significantly cut travel agency transaction fees. And while most companies focus on savings opportunities on ticket prices and room rates, there are also significant process savings to be realized by automating the business travel expense reporting process. Electronic expense report solutions linked to online booking tools and/or corporate cards can cut \$25-\$75 per reconciled expense report, on average. Automated reporting solutions improve productivity by cutting time employees spend on their reports and cut costs by catching and eliminating out-of-policy expenditures.

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Bringing New Artistry to In-Flight Dining



While other carriers are cutting corners on meals, **Malaysia Airlines** is actually enhancing the dining experience and bringing glamour back to in-flight dining. Well-known chefs from all over the world have developed exciting new menus, a series of award-winning wines has been selected for a cellar-in-the-sky, and a new à la carte service allows passengers to choose from an array of ethnic, vegetarian and organic dishes. There are even personal breadbaskets filled with artisan breads.

Signature dishes draw inspiration from modern French cuisine and authentic Asian dishes. The new menu items, from lamb shank in Sarawak black pepper sauce to baked North Atlantic black cod to satay, are very much in keeping with Malaysia Airlines' philosophy of going beyond expectations. That includes considering the entire fine dining experience, not just the cuisine. Passengers can expect the same attention to details they would get in any top restaurant on the ground. This includes silver cutlery, Italian glassware, Wedgwood tableware, and individual French presses for coffee.

For more information: www.malaysiaairlinesusa.com.

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The S&P/
BusinessWeek
Annual
Awards

The Best Fund Managers

Just in: The results of the Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards for 2006

SCREENS AND SCOREBOARDS are great tools for identifying potential investments quickly. But when you get hundreds of choices, you're going to need more help. That's where the 2006 Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards come in handy. Fund selection starts with 810 funds rated A or B+ for the five years ended Dec. 31, 2005, in the *BusinessWeek* Mutual Fund Scoreboard (BW—Jan. 23). Our ratings are based on risk-adjusted total returns, an evaluation that favors funds with strong and steady returns, not necessarily those with the greatest gains. We then apply other criteria: assets of at least \$100 million, a manager with at least five years' tenure, and a minimum investment of less than \$26,000. Also, of course, the fund should be open to new investors. That's the reason two of last year's winners, Julius Baer International Equity and Laudus Rosenberg International Small Cap, are no longer on the list. They're closed to new shareholders. Once a fund has jumped

all those hurdles, S&P's fund analysts conduct in-depth, face-to-face interviews with managers to quiz them on investment practices. (S&P, like *BusinessWeek*, is owned by The McGraw-Hill Companies.)

The result? A list of 18 funds that feature consistent investment philosophies and security selection guided by seasoned pros. "While you can't guarantee future returns, we have confidence these managers can run these funds no matter what comes their way," says S&P mutual fund strategist Roseanne Pane. Among the eight first-time winners are Janus Mid Cap Value Fund and Stratton Growth Fund (table). Repeaters include Bill Miller's Legg Mason Value Trust and the team-managed Growth Fund of America.

On the pages that follow, you'll find profiles of four of our newcomers. For information on the other 14 funds, plus Q&As, free S&P reports, and other fund-picking tools, go to *BusinessWeek* Online (box). Choosing funds is a lot easier if knowledgeable folks have already done some of the work. ■

—Lauren Young

Our First-Time Award Winners

FUND / SYMBOL	CATEGORY	PORTFOLIO MANAGER
Fidelity Short Term Bond FSHBX	Short Bond	Andrew Dudley
First American Real Estate FARCX	Real Estate	J. Wenker/J. Rosenberg
Goldman Sachs High Yield GSHAX	High Yield	A. Jessop/R. Golder
Janus Mid Cap Value JMCVX	Mid-cap Value	T. Perkins/R. Perkins/J. Kautz
Oppenheimer Main St. Small Cap OPMSX	Small-cap Blend	N. Monoyios/M. Zavanelli
Stratton Growth STRGX	All Cap	James Stratton
Templeton Global Bond TPINX	Intl. Bond	A. Calvo/M. Hasenstab
Thornburg International Value TGVAX	Foreign	W. Fries/W. Trevisani/L. Wang

BusinessWeek online For more on the Excellence in Fund Management Awards, go to businessweek.com/go/06fundmanagers.htm. You'll find profiles of all 18 winning funds, Q&As with several managers, a slide show, and a video view with S&P's Phil Edwards. In addition, there are free S&P reports on each of the award winners



Value in The Genes

Janus Mid Cap's Perkins
brothers can spot bargains

JANUS MID CAP VALUE Fund has always been an outlier in the Janus empire. Its managers, with offices in San Francisco and Chicago, operate independently of Denver-based Janus. While Janus is synonymous with earnings-driven growth stocks, the team that runs the \$5.8 billion mid-cap fund zeroes in on value-priced equities.

Their searches led them to the energy sector in 1999, when oil was trading near \$13 a barrel. "We aren't great economists or energy analysts," says Tom Perkins, 61, who leads the fund with his older brother, Bob, 65. "But it seemed to us that [number] was probably out of bounds for the price of energy."

An oversized bet on energy companies helped fuel the fund's annualized 13.8% gain in the 2001-2005 period. The team, which includes 37-year-old Assistant Manager Jeff Kautz, recently cut the fund's energy weighting to 10%, from 15%, and shifted emphasis to production companies such as Noble Energy

and Anadarko Petroleum. "We feel more comfortable having the assets in the ground," Perkins says.

In order to stay focused on the risk-reward tradeoff, the trio sets targets, ideally a 40% potential gain with a worst-case loss of no more than 20%. "We are much more concerned with how the fund performs on the downside than with how we

JANUS MID-CAP VALUE

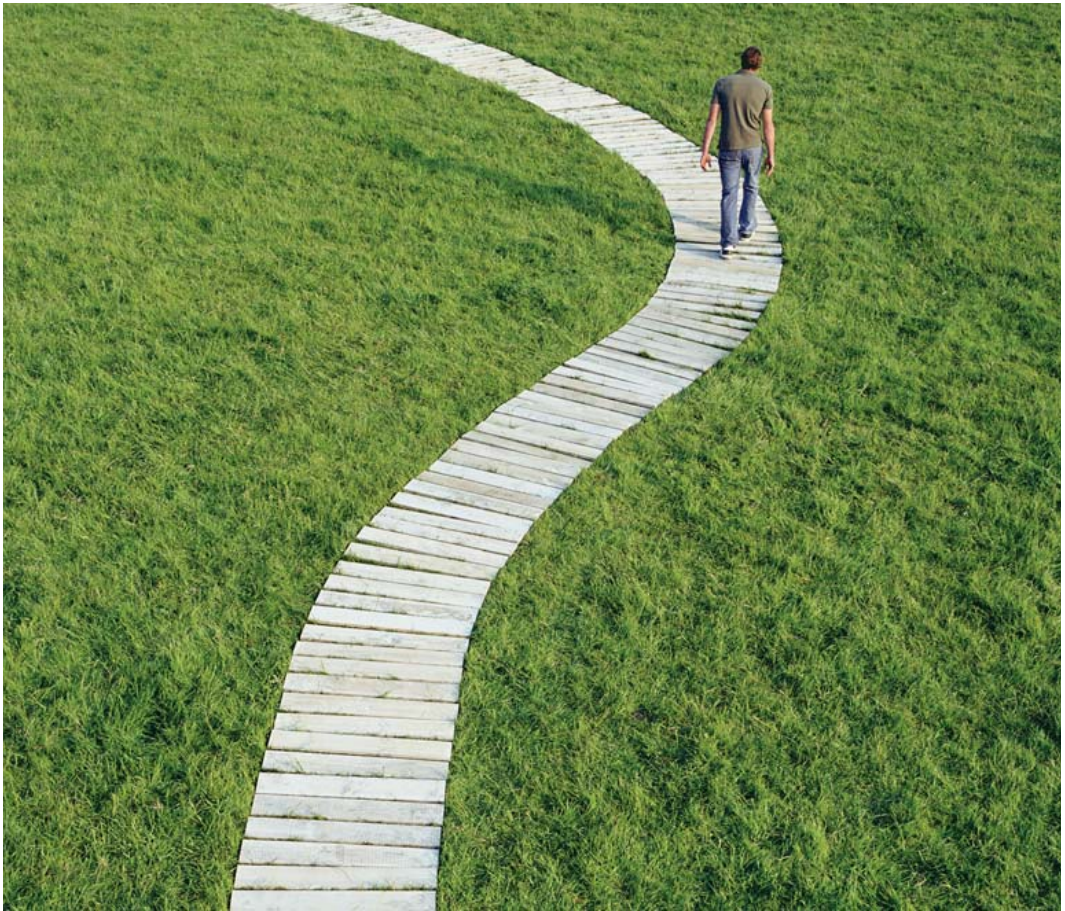
CATEGORY
Mid-cap Value

**PORTFOLIO
MANAGERS (L-R)**
Jeffrey Kautz
Thomas Perkins
Robert Perkins

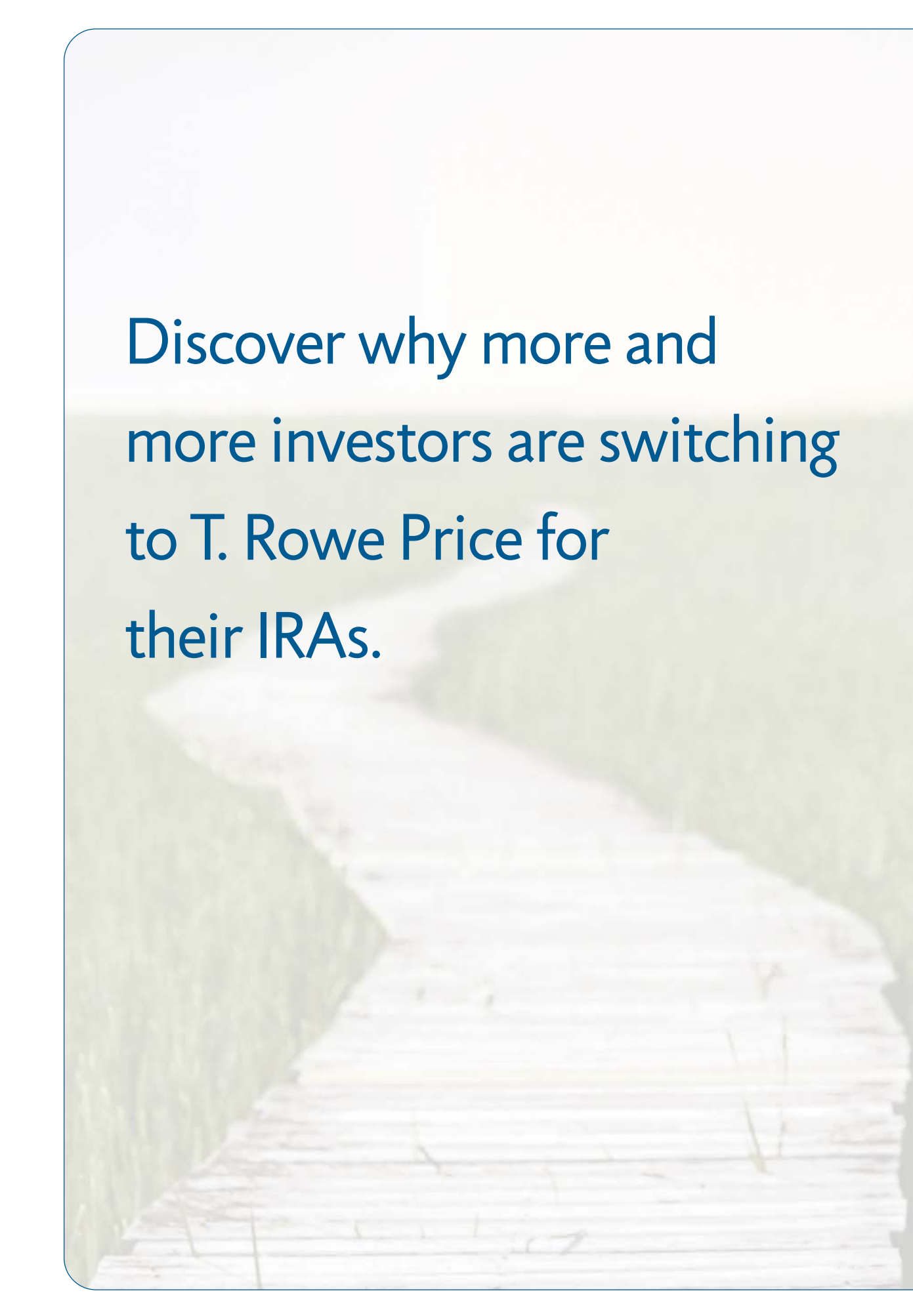
**AVERAGE ANNUAL
TOTAL RETURN***
13.8%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-2005

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A photograph of a wooden boardwalk or path made of light-colored wooden planks, winding through a green, grassy field. The path leads towards a bright, hazy horizon under a clear sky. The image is slightly blurred, giving it a soft, dreamy feel.

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*Based on fiscal year-end data available as of 12/31/05. (Source for data: Lipper Inc.)

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100% No-Load Funds	Average annual total returns as of 12/31/05		
	1 Year	5 Year	10 Year
Balanced Fund	5.52%	4.47%	8.27%
Lipper Balanced Funds Average	4.69%	2.67%	7.17%
Capital Appreciation Fund	6.85%	11.37%	12.40%
Lipper Multi-Cap Value Funds Average	6.37%	5.42%	9.70%
Global Stock Fund ¹	22.74%	4.13%	9.22%
Lipper Global Large-Cap Growth Funds Average	10.17%	-0.89%	6.47%
Growth Stock Fund	6.56%	1.38%	9.92%
Lipper Large-Cap Growth Funds Average	6.20%	-3.99%	6.67%
Spectrum Growth Fund	9.47%	4.59%	9.31%
Lipper Multi-Cap Core Funds Average	6.58%	1.65%	9.01%

When assessing performance, investors should consider both short- and long-term returns. Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or loss when you sell your shares. To obtain the most recent month-end performance, call us or visit our Web site. Request a prospectus or a briefer profile; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing. All mutual funds are subject to market risk, including possible loss of principal. International investing has special risks, including currency fluctuations. ¹The performance information shown does not reflect the deduction of a 2% redemption fee on shares held for three months or less. If it did, the performance would be lower.

Results will vary for other time periods. Past performance cannot guarantee future results.

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Average annual total return figures include changes in principal value, reinvested dividends, and capital gain distributions. ***Based on cumulative total return, 97 of 138, 74 of 93, and 47 of 64 T. Rowe Price funds (including all share classes and excluding funds used in insurance products) outperformed their Lipper average for the 1-, 5-, and 10-year periods ended 12/31/05, respectively. Not all funds outperformed for all periods. (Source for data: Lipper Inc.)

T. Rowe Price Investment Services, Inc., Distributor.

IRAG073471

do on the upside,” says Perkins.

The managers take profits when stocks reach those price targets. That happened in 2005, when they sold longtime holdings Legg Mason and Franklin Resources and replaced them with a languishing Alliance Capital Management. With a 6% yield and a full line of global investment products, Alliance Capital looked like a smart bet.

Since then, the stock has gained 42% and has become the fund's largest holding.

Finding those deals is tough, which is why the fund has 13% in cash. Perkins doesn't expect to put that money to work anytime soon. “The values aren't there the way they used to be,” he says.

In their spare time, the Perkins brothers practice philanthropy. Tom

supports reproductive rights groups, while Bob sponsors a charter school in Chicago and other educational initiatives. Kautz is involved in educational programs, too. Since nearly all of their money is invested in the fund, the better the performance, the more they have to give away. ■

—Lauren Young



Monoyios, 57, and Zavanelli, 35, use a quantitative model that collects massive amounts of data about the companies and stocks' trading patterns, and they adjust their holdings as market conditions change. That means they might trade 300 stocks in a week. About 80% of the time, adjustments are made with “program trading”—the buying or selling of a large basket of stocks.

OPPENHEIMER MAIN STREET SMALL CAP

CATEGORY

Small-cap Blend

PORTFOLIO MANAGERS (L-R)

Nikolaos Monoyios,
Mark Zavanelli

AVERAGE ANNUAL
TOTAL RETURN*

12.7%

*Appreciation plus reinvestment
of dividends and capital gains
before taxes, 2001-2005

Zavanelli has been running this small-cap fund for six years (Monoyios joined in 2003), but their quantitative model is a work in progress since factors that helped identify trends a year ago don't necessarily work now. “We

believe in continuous improvement,” Monoyios says.

If the model is positive about a stock, Zavanelli and Monoyios will increase its weighting vs. the Russell index. Likewise, they'll pare the position if their model cools on it. “Some people say it looks like an index fund,” Zavanelli admits, but his partner quickly notes that the fund's returns far exceed the index. “There's no way anyone can accuse us of being an index fund.”

Right now, the managers have upped the ante in technology and consumer discretionary sectors (such as retailing, restaurants, and entertainment) and are underplaying financial and health-care stocks. They have also cut the portion of the fund in the smallest stocks, known as micro-caps, and boosted mid-caps, given their view that the outside gains of small stocks over the past six years can't go on much longer. “We try not to fall in love with stocks or become overconfident,” says Monoyios, “because something very bad could happen.” Something like a long string of strikeouts. ■

—Karyn McCormack

They Know Real Estate

The hands-on managers
behind First American

JOHN WENKER AND JAY ROSENBERG are real estate junkies. Heading to the airport after a conference in Palm Beach in March, they took a detour to a two-acre vacant lot owned by Kite Realty Group, a holding in the \$740 million First American Real Estate Securities Fund, which they jointly manage. The land won't be developed for more than a year. Most real estate fund managers wouldn't have bothered to peer at a weed-filled site.

But Wenker and Rosenberg like to look into each company's pipeline of projects using skills they picked up earlier in their careers. Wenker, 54, got his



ROSENBERG
AND WENKER

(L-R) PHOTOGRAPHS BY RUDY ARCHULETA/REDUX; THOMAS STRAND

Eye on the Small-Fry

This Oppenheimer fund
juggles 1,200 stocks at a time

ONE WAY TO RUN A MUTUAL fund is to make a handful of big bets on stocks and hope for a few home runs. The funds that do that often make headlines when they win—and lose. Nikolaos Monoyios and Mark Zavanelli take the opposite approach in Oppenheimer Main Street Small Cap Fund. With tiny positions in some 1,200 stocks, they're aiming for lots of base hits. For the 2001-05 period, they earned an average annual return of 12.7%, vs. 8.2% for the benchmark Russell 2000 index.

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start in the 1970s working for the city of St. Paul, Minn., first assessing property and later overseeing new developments. Rosenberg, 34, built industrial buildings in the Midwest before becoming a fund manager. "We have hands-on experience, and we like to get out and take a look," says Wenker.

Their diligence has helped First American produce annualized gains of nearly 20% in the 2001-2005 period, about one percentage point better than the average real estate mutual fund, according to Standard & Poor's. Unlike many of their competitors, the managers also look beyond real estate investment trusts (REITs) to operating companies, such as Hilton Hotels, that have substantial property on their balance sheets. Such outfits don't necessarily pay dividends as

high as REITs, but they often trade at a substantial discount to the trusts and provide a cushion when the market turns against the sector. That has helped First American outperform in weak REIT markets, like the one last summer. "We're looking at a lot of companies a lot of our peers have never even heard of," says Rosenberg.

Another overlooked segment, small-cap REITs that aren't followed by Wall Street analysts, have also proven profitable. The duo put almost 2% of the fund into tiny First Potomac Realty Trust, with a market capitalization just under \$600 million, which gained 17% last year. First Potomac's

FIRST AMERICAN REAL ESTATE

CATEGORY
Real Estate

PORTFOLIO MANAGERS
John Wenker,
Jay Rosenberg

AVERAGE ANNUAL TOTAL RETURN*
19.9%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-05

savvy management buys underutilized office and industrial properties in the Washington (D.C.) area.

After a tremendous five-year run in the REIT sector, average dividend yields are below that of the 10-year U.S. Treasury bond, a danger signal in prior rallies. But considerable mergers-and-acquisitions activity has helped the sector post strong performance, says Rosenberg. Rising

interest rates will eventually deter those buyers. "We're due for a little payback," says Rosenberg. With its quirky style, though, the fund should outperform its peers even in a downturn. ■

—Aaron Pressman

Any Stock is Fair Game

James Stratton has picked winners of all stripes since '72

THE TERM THAT MOST APTLY describes James Stratton is "old school." Stratton, 69, has been managing money since 1960, and the \$175 million Stratton Growth Fund since 1972. In fact, the fund is so old that Stratton says it may be mislabeled by today's standards. "When we put 'growth' in the title, the mutual fund market wasn't divided into growth and value investing," he says. "We just wanted the money in the fund to grow."

Indeed, the *BusinessWeek* Mutual Fund Scoreboard categorizes Stratton Growth, based in Plymouth Meeting, Pa., as an all-cap fund because Stratton buys stocks in companies of all sizes. He finds them by ranking shares on six valuation criteria, including price-earnings and price-to-cash-flow ratios, as well as some growth-oriented momentum stats,

STRATTON GROWTH

CATEGORY
All Cap

PORTFOLIO MANAGER
James Stratton

AVERAGE ANNUAL TOTAL RETURN*
11.7%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-05



such as one that measures the rate of change of analysts' earnings estimates. About 70% of the ranking is determined by value criteria and 30% by growth criteria. "I don't want to buy a cheap stock that just sits there," Stratton says. "The company needs some sort of catalyst for improvement."

Stratton says the fund's flexibility is an advantage, allowing him to own a worldclass blue chip such as Caterpillar, which has a \$50 billion market cap, alongside oil-exploration company Penn Virginia, with one of \$1.2 billion. Currently he prefers energy

stocks, particularly smaller producers, which tend to have lower valuations and are in a better position to benefit from higher oil prices than majors such as ExxonMobil.

He also favors railroad stocks Burlington Northern Santa Fe and Norfolk Southern, which have market caps of upwards of \$20 billion. "There are no small railroad companies," he notes. "If this was a small-cap fund, I'd be shut out." He's bullish on the rails because they're more fuel-efficient than truckers and cheaper for shippers to use.

Since launching on Sept. 30, 1972, the fund has garnered a 4,118% cumulative return, or 12.14% annualized, vs. 3,244% or 11.12% for the Standard & Poor's 500-stock index. That one percentage point difference doesn't sound like a lot, but over 33 years it adds up.

Stratton attributes part of his success to a cautious optimism, something he doesn't see much of today. "The level of cynicism is much greater today" than in the '70s, he says. "Now when a company comes out with earnings, all people want to do is find out what's wrong with it. If you get good news, the stock still goes down. I don't think it's a healthy attitude. It makes everybody too short-term oriented." With nearly half a century of investing under his belt, this is one manager no one could accuse of thinking short term. ■

—Lewis Braham

CHRIS CRISMAN

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Lipper Quartile Rankings as of 1/31/06, based on total returns

Fund (inception date)

Category	1-Year	3-Year	5-Year	Life of Fund
Janus Adviser Forty Fund - S Shares ^{1,2,3} (5/97) Large-Cap Growth Funds	1st (31 of 687)	1st (57 of 599)	1st (18 of 475)	1st + (1 of 207)
Janus Contrarian Fund ^{4,5,6} (2/00) Multi-Cap Core Funds	1st (19 of 831)	1st (3 of 600)	1st (26 of 419)	1st (37 of 338)
Janus Core Equity Fund (6/96) Large-Cap Core Funds	1st (8 of 886)	1st (10 of 763)	1st (11 of 617)	1st (3 of 260)
Janus Growth & Income Fund (5/91) Large-Cap Core Funds	1st (19 of 886)	1st (32 of 763)	1st (80 of 617)	1st + (3 of 103)
Janus Orion Fund ^{6,7} (6/00) Multi-Cap Growth Funds	1st (23 of 411)	1st (11 of 364)	1st (37 of 285)	2nd (74 of 231)
Janus Twenty Fund ^{3,+} (4/85) Large-Cap Growth Funds	1st (50 of 687)	1st (8 of 599)	1st (119 of 475)	1st (2 of 41)

¹(Formerly I Shares) ⁴Closed to new investors.

Lipper ranks Janus Growth and Income Fund in the 1st quartile, 3 of 234, for the 10-year period in the Large-Cap Core Funds category.

Lipper ranks Janus Twenty Fund in the 1st quartile, 2 of 165 and 2 of 59, for the 10- and 15-year periods, respectively, in the Large-Cap Growth Funds category.

Please consider the charges, risks, expenses and investment objectives carefully before investing. For a prospectus containing this and other information, please call your financial advisor or Janus or download the file on janus.com. Read it carefully before you invest or send money.

Past performance is no guarantee of future results. Funds may have experienced negative performance results. There is no guarantee the stated objective will be achieved. Results will vary for other time periods.

²Ranking is for the S share class only; other classes may have different performance characteristics. ³The date of the since-inception Lipper rankings is slightly different from when the fund began operation since Lipper provides fund rankings as of the last day of the month or the first Thursday after fund inception.

³Returns have sustained significant gains due to market volatility in the health care sector.

⁴This Fund buys stock in overlooked or underappreciated companies of any size, in any sector. Overlooked and underappreciated stocks present special risks.

⁵The Fund held approximately 20% of its assets in Indian securities as of 9/30/05, and the Fund has experienced significant gains due, in part, to its investments in India. While holdings are subject to change without notice, the Fund's returns and NAV may be affected to a large degree by fluctuations in currency exchange rates or political or economic conditions in India.

⁶The Fund may have significant exposure to emerging markets. In general, emerging market investments have historically been subject to significant gains and/or losses. As such, the Fund's returns and NAV may be subject to such volatility.

⁷Returns have sustained significant gains due to investments in Brazil. As of 12/31/05, the fund held approximately 9.8% of its assets in Brazilian securities. As a result, returns and NAV may be affected to a large degree by fluctuations in currency exchange rates or political or economic conditions in Brazil. Holdings are subject to change without notice.

Differences between compared investments may include objectives, sales and management fees, liquidity, volatility, tax features and other features, which may result in differences in performance.

Lipper, Inc. - A Reuters Company, is a nationally recognized organization that ranks the performance of mutual funds within a universe of funds that have similar investment objectives. Rankings are historical and are based on total return with capital gains and dividends reinvested. Funds distributed by Janus Distributors LLC (3/06).



Out of the Attic, Into the Hard Drive

Scanning snapshots and slides can help preserve those memories forever. **BY LARRY ARMSTRONG**

IF YOU'RE LIKE MOST OF US, you've got your recent snapshots stored on your computer or a stack of CDs. But what about the real treasures, old family photos and slides that go back for generations? You've most likely stashed shoeboxes full of snapshots along with the negatives, disintegrating albums, and slide carousels in the attic or basement.

It's time you brought the family archives into the digital age. Why would you want to? For one thing, you can stop—or even reverse—the deterioration, restoring the vibrancy to your old color photos, or the crispness of black-and-whites. Digital prints made on modern inkjet printers will last longer without fading or changing colors than those made from film. It's easier to view the dig-

ital copies on a computer or TV than it is to drag out and set up a slide projector and screen. And it's cheaper to make copies for family and friends (and the safe-deposit box).

What you'll need is a scanner and computer. If you set the scanner for the best quality and store the files in the uncompressed TIFF format, both of which I recommend, you'll want a DVD burner as well. With file sizes of 50 to 100 megabytes or more for each negative or slide you scan, a DVD will hold hundreds of images, vs. a dozen or so per CD.

While you can make pretty good copies of snapshots on an inexpensive all-in-one printer, which comes with a built-in scanner, I've been looking at standalone scanners. Some are designed to handle film and slides, and to deal with the multitude of problems you are likely to encounter with old photos, such as faded prints, dust on slides, or scratches on film negatives.

HIGH RESOLUTION

THE TYPE OF SCANNER you need to buy depends on what you want to preserve. If you have mostly old snapshots in envelopes or albums, but without negatives, your best bet is a flatbed scanner. Top-rated models include the Canon CanoScan 9950F, which lists for \$400, and Epson's new \$550 Perfection V700 Photo. (Retail prices are usually lower.)

These flatbed scanners are designed primarily for photographs and documents. But they have the high resolution you need for copying film and slides—up to 6,400 pixels per inch in the case of the Epson—and they have the back light and film holders you need to scan transparencies. In fact, if your slides or negatives are something other than 35mm film, such as 2.25 in. or 4 x 5 in., these scanners are the best for film.

If, on the other hand, you have trays full of 35mm slides, or you've saved every negative in the envelopes that your prints came in (as many people have), you'll get more satisfactory results from a dedicated film scanner. These tend to do a better job picking up details in the dark areas of a photograph. But your choices

ILLUSTRATION BY TERRY ALLEN

Saving Old Photos



FLATBED SCANNERS

such as Epson's Perfection V700 Photo (\$550) are the most versatile, scanning both photo prints and batches of positive and negative film transparencies (epson.com)



FILM SCANNERS

such as Nikon's Coolscan V ED (\$600) give the best results for individual slides or strips of negatives, but the sizes they can handle are limited (nikoncoolscan.com)

are pretty limited. The gold standard is Nikon's \$600 Coolscan V ED, which can scan negatives or slides at up to 4,000 dots per inch. Unlike a flatbed scanner, it won't take up much room on your desk—it's less than 4 in. wide and about 12 in. deep. It's also fast, scanning a negative in under 40 seconds, instead of the 4 minutes the Epson takes at its best settings.

Another choice is a film or slide scanner from Pacific Image Electronics, which specializes in them. I looked at the company's PowerSlide 3650, which will list for \$899 when it comes out in May, and will probably sell at retail for \$850 or less. Its big advantage is you can load up to 50 slides in the tray and it will scan them automatically at resolutions up to 3,600 pixels per inch. The comparable Nikon setup, the Super Coolscan 5000 ED with optional 50-slide feeder, will set you back about \$1,500.

One reason these gizmos are so expensive is that the high-end versions come with a very powerful image enhancement package from Kodak called Digital ICE. ICE uses software to remove dust and scratches from your film and slides, but requires special hardware and a second scan over the slide or negative to do it. The extra scan uses infrared light, looking for three-dimensional defects such as fingerprints or specks of dust. The software also can soften the graininess you sometimes see in high-speed film and restore the original color when it has obviously faded or changed.

Don't be too aggressive when you clean your prints or film; a soft cloth for fingerprints and bulb-type air blower for dust are safe. Scan, and save your scans, at the highest resolution. It takes more time, but that will let you print bigger enlargements or crop and print only the part of the photo you want. Finally, when you're all done, return the original film or slides to the attic.

This is no Saturday afternoon project. Depending on how many photos you want to digitize, it will take weeks to make a dent in your treasure trove. But once you've finished, you can enjoy those old photos as you never have before. ■



AUTO SCANNERS

such as Pacific Image's PowerSlide 3650 (\$780-\$850) can automatically load and scan up to 50 slides (scanace.com)

Behind the Wheel of GM's Great Wide Hope

The redesigned Yukon is best-in-class. But it's defending a shrinking market. **BY DAVID WELCH**

WHEN GENERAL Motors decided to spend a few hundred million bucks last year to rush its redesigned large SUVs to market six months early, everyone thought company executives had to be crazy. High fuel prices had already taken a big bite out of sales. Consumers were wild for small SUVs. The fact that GM was still relying on eight-seat gas hogs to save the company seemed so old Detroit.

But when you're king of the road in a particular market, you have to defend it. So I jumped in a new GMC Yukon to see if this truck had a prayer of towing GM out of the mire. I have to say, if you're one of those buyers who still want a big brute of a truck, these large sport utes are best-in-class.

Stylistically, it doesn't look that much different than the old Yukon and its stablemate, the Chevrolet Tahoe. You have to get behind the wheel to find out what the truck is really made of. And let's make one thing clear: Though GM engineers tried their best to bend the laws of physics and make this brute drive more like a car, the Yukon is still a massive truck. Parking it in a garage or crowded lot is a neck-craning exercise in navigation.

Having said that, it's about as smooth and nimble a big SUV as you'll find. I drove the car for seven hours across Canada on a road trip. When it comes to loading up a lot of baggage and cruising for a few hundred miles, the Yukon is a

comfy ride. The new front suspension lets you coast over potholes without the bone-shaking ride many competing large trucks have. For a truck this heavy (it weighs 5,000 pounds) the Yukon also takes tight turns without leaning too hard to one side. Its turning radius is pretty good, too. I had to make a quick U-turn on a four-lane road and was able to do so without having to stop, back up, and go forward again.

GMC YUKON



A better interior and a smoother ride. Still, it gets less than 20 mpg

The cabin is nicely decked out. GM finally ditched the cheap, hollow plastic knobs that belong on the dashboard of a toddler's toy car. In their place is a solid set of knobs and buttons that look like they are built with the precision of Honda or Toyota. One gripe: GMC is supposed to be GM's upscale brand, but for \$38,500 I expect-

ed heated leather seats rather than cloth-wrapped benches more befitting a Chevy.

Forget about the 20 miles per gallon that GM bragged about before introducing the new Yukon. I got 15.5 mpg on my trip, albeit driving about 75 mph on the highway. I still think this is the best large SUV on the market, but its gas-hogging ways and outsize body make it a choice for SUV lovers only. ■

Aquavit, in Some Far-Out Flavors

The Nordic liquor gets an update, with tastes ranging from lingonberry to saffron. **BY DAVID KILEY**

YOU KNOW THINGS ARE going to get interesting when the drink menu features horseradish-infused aquavit. That's one of the offerings at Scandinavian restaurant Aquavit in New York. The place takes its name from the national drink of Sweden and may be doing as much to advance Swedish culinary expertise as Volvo has done for auto safety.

Aquavit nowadays is produced in Denmark, Finland, Germany, Norway, and Sweden, starting with alcohol from either grain or potatoes, fermented and distilled twice. When people with imagination and skill steep the odorless and colorless alcohol with fresh fruits, herbs, and botanicals, they deliver a distinctive and slightly buttery libation bursting with flavors far superior to those of mass-produced flavored vodkas. Such carefully concocted spirits are best ice-cold and can be drunk on their own or astutely matched with food at a meal.

A few commercially available aquavits are underwhelming representations of 500 years of distilling experience. The Swedish OP Anderson (\$22-\$25 for a 750-ml bottle) is amber, owing to aging in oak casks, and has the strong taste of caraway, anise, and fennel. From Denmark, Aalborg Jubilaeums Akvavit (\$20) has a noticeable dill flavor, along with coriander and a hint of star anise. Aalborg Akvavit (\$19) has the traditional distinct caraway flavor.

Aquavit restaurant owner Hakan Swahn and head chef Marcus Samuelsson, however, cross a new fjord when it



AT NEW YORK'S AQUAVIT Vodka infused with white cranberry (above) or orange clove



comes to making the Old World spirit both in homemade stuff crafted at the restaurant and in the bottled aquavit they recently have begun to supply to liquor stores. Among the aquavits on the restaurant's menu these days are lingonberry, cucumber, raspberry-lime-ginger, orange-lemon, grapefruit-lemongrass, saffron, and pumpkin-espresso.

To make the aquavit that is handcrafted at the restaurant, Swahn starts with what he calls "a good shelf vodka" and adds flavor. Aquavit doesn't become aquavit until it's a finished flavored product. In the case of the orange-lemon, the vodka was allowed to steep together with fresh fruit for three weeks to a month. Then the spirit was strained through a large coffee filter. The result is a slightly cloudy fusion of citrus flavors with plankton-like bits of pulp that has a bright, sumptuous taste and long, smooth finish. Since Swahn started with a 70-proof spirit, it did not have the bracing, almost medicinal shock of an 80-proof vodka such as Absolut Citron (\$22) or Stolichnaya Limonnaya (\$19-\$24).

The variety of flavors and ingredients that the restaurant turns out in small batches makes matching the results with its dishes an adventure. "When you don't come from a wine-producing country, you can get very creative with spirits," says Samuelsson. The horseradish aquavit was brilliant with the herring sampler and a better match than any Riesling or even beer I might have ordered. The unlikely, but delicious, pumpkin-espresso aquavit, made from steeping baked, brown-sugar-laced pumpkin in vodka for a month and adding espresso beans in the mixture for a week, complemented a venison loin with fennel, caramelized ginger, celeriac purée, and apple-pine broth.

You don't have to go to the restaurant to sample the new generation of aquavit. Swahn took one of

the more popular handmade flavors from the bar, white cranberry, and made it his first commercially available aquavit. Produced from cranberry concentrate from New England, and distilled in Sweden, his bottled Aquavit has a small amount of caraway, too, as required by the Swedish government. At \$28 per bottle, Aquavit New York is rolling out in major cities.

The taste and mouth feel of these aquavits tilt toward liqueur, though they aren't nearly as viscous as, say, an anisette. That makes this new class of aquavit unique, a delight with or without herring, and a refreshing alternative to factory-made flavored vodkas. Skool! ■

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EDITED BY MONICA GAGNIER

TRAVEL

FIRST-CLASS BLANKIE, EVEN IN COACH

GIVEN THE SCARCITY of blankets on airplanes, it makes sense to bring your own. Our pick is the \$30 CoolMax Travel Blanket from Cocoon



(cocoonusa.com), which also happens to sell our favorite goose down travel pillow for \$24. The blanket is made of a knit polyester that feels luxuriously soft and warm and moves with your body better than woven blankets. While it opens to a generous 55 inches by 70 inches, the blanket

packs down in its own drawstring bag to a briefcase-friendly 3½ inches by 7 inches, the smallest on the market. You'll have space to pack a snack, something else in short supply on planes.

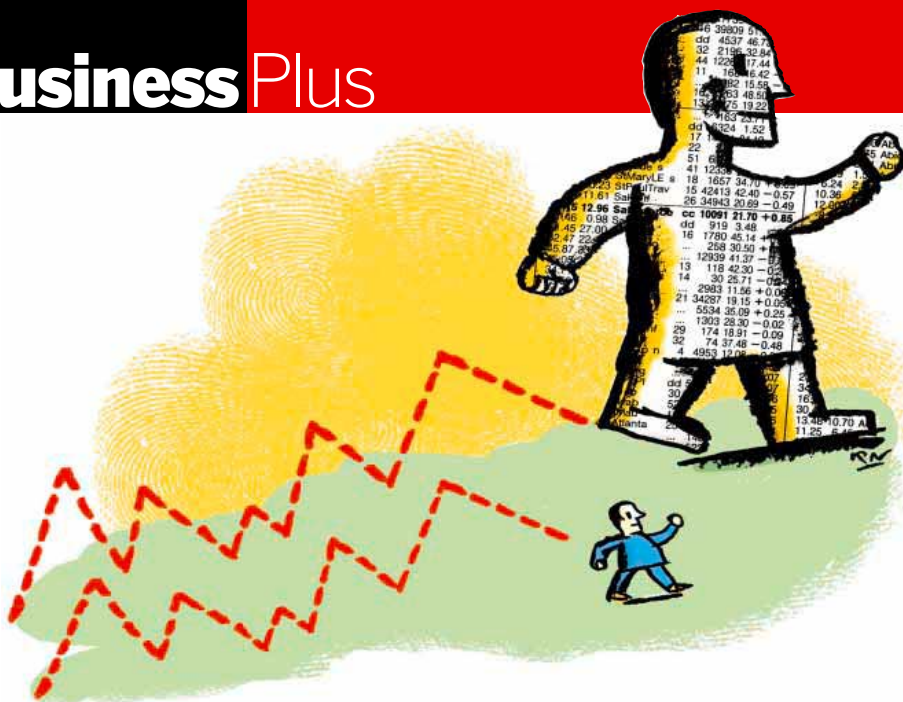
—Larry Armstrong

COMMODITIES

GOING TO THE SOURCE

MOST PEOPLE KNOW the benefits of diversifying their portfolio with commodities. But did you realize that it's better to invest in the actual commodities than in the stocks of commodity producers? That's one finding of a new study by Gary Gorton of the Wharton School and K. Geert Rouwenhorst at Yale School of Management. Looking at returns since 1962, the pair found that commodity stocks had a 0.57 correlation with the Standard & Poor's 500-stock index, larger than the 0.4 correlation between the commodity stocks and commodities. When the stock market had its worst month out of 100, losing 14% on average, commodities rose more than 2%. Luckily for investors, a growing number of mutual and exchange-traded funds give direct exposure to commodity prices. So don't forget the pork bellies and crude.

—Aaron Pressman



ANNUITIES

Follow the Index

IF YOU OWN A VARIABLE ANNUITY and you've held it long enough to avoid surrender charges, consider switching to one that invests in exchange-traded funds. ETFs are fixed baskets of securities that track a specific benchmark, such as the Dow Jones industrial average, and are among the lowest-cost investments around. So variable annuities that invest in ETFs can be less pricey than traditional ones.

Integrity Life Insurance charges 0.69% to 0.77% of assets for its ETF-based annuities, plus 0.60% for fees associated with the annuity, like the mortality and expense risk charge—making it cheaper than your average offering at 2.3%. Other players, such as Jackson National Life Insurance, have been looking at ETFs as well.

But beware: Not all ETF-based products are cheaper than your average annuity. MetLife, which has teamed up with brokerage A.G. Edwards for its new asset-allocation product that can invest in fixed-income, stock, and real estate ETFs, charges 1.10% to 1.15% for the underlying assets and around 1.3% for the bells and whistles of the annuity.

—Adrienne Carter

HOT WHEELS

YOU WON'T FIND THIS ON eBay

PINING FOR THE new Bentley Continental GTC, the convertible version of the Continental GT coupe?

Then no doubt you've heard about the top speed of 195 mph, the 12-cylinder engine, and the special rear suspension. Well, there are 1,500 orders for the luxury soft top, and it could take up to nine months to get to the top of the list.



THE NEW BENTLEY

But you have a way to get into the fast lane: Bid on the first model to arrive in North America. Sotheby's will auction it off at the East Side House Settlement Gala, to be held at the Jacob Javits Center on Apr. 13. The gala includes a sneak peak of the New York International Auto Show, which opens on Apr. 15.

Bentley bidders can buy tickets to the cocktail party for \$150, or dinner for \$1,000. You can also place a phone bid by calling 248 754-4531 by Apr. 10. The sticker price hasn't been announced, but you can bet it will be in the \$100,000-to-\$200,000 range.

—Chester Dawson

ILLUSTRATION BY ROBERT NEUBECKER

Which top CEO listens to Guns N' Roses?

Who likes to eat his pancakes with salt?

Whose Dad wanted him to work in a meat packing plant rather than go to college?

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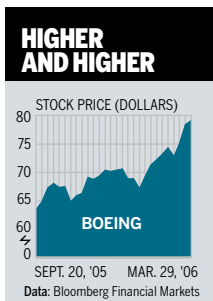
BOEING HAS GAINED ALTITUDE FAST AND COULD GAIN LOTS MORE.

XTO IS A NATURAL PREDATOR FOR PIONEER NATURAL RESOURCES.

GETTING SIRIUS: SHOCK JOCK STERN REELS IN THE SUBSCRIBERS.

Boeing: Up in the Clouds

SINCE DIVING FROM 51 IN 2003 to a three-year low of 24, Boeing (BA) has soared to 78—and the smart money says it'll keep going. "It has strong free cash flow, which will continue as it fills 2005 orders," says Standard & Poor's Jim Corridore, who upgraded the stock from "hold," to "buy," with a 12-month target of 85. (Boeing was featured in this column on Feb. 21, 2005, at 54.) Orders this year may not match 2005's, but financial results will be strong, he says. Corridore is upbeat on CEO James McNerney, who, he says, can push up debt-adjusted return on equity to 15%-17% for the next 10 years. Compounded free-cash-flow growth, he estimates, will hit 7.5% to 8.5%. And earnings before interest and taxes, he adds, should rise from 6% to over 8%. Ronald Epstein of Merrill Lynch, which has done business with Boeing, writes that "better-than-expected demand" globally for the 787 will increase deliveries in 2008 to 450 aircraft from an estimated 425 in 2007 and 405 in 2006. Output, Epstein figures, will stay at that level through 2010. The 787 "is a category killer," he says. Recently, he upped his profit estimate for 2006 from \$3.35 a share to \$3.40 and for 2007 from \$4.20 to \$4.30. The figures might be conservative, he adds. Value Line's Morton Siegel notes that the 787, slated to appear in 2008, is already nearly sold out through 2010. A bigger 787 will enter service in 2012. Siegel sees Boeing performing well for years to come.



Why Pioneer Is Prime Buyout Bait

CONSOLIDATION IN THE OIL PATCH will heat up, says Fadel Gheit of Oppenheimer. And Pioneer Natural Resources (PXD), an independent \$5.1 billion oil-and-gas outfit, is one of the most attractive targets, he says. Gheit argues that Pioneer's recent sale of \$1.6 billion in assets will let it focus on exploring for natural gas in North America. That would play into the strategy of XTO Energy, a \$16 billion producer and an eager buyer of onshore gas in the U.S. Gheit expects XTO to go after Pioneer because of its reserves and its strong cash flow—plus its \$1.6 billion hoard from selling assets in the Gulf of Mexico and Argentina. Pioneer, down from 56 in September to 43 now, is worth 60 a share based on its assets, says Gheit.

Pioneer's 866 million barrels of proven reserves are valued at just \$11 a barrel vs. peers' \$15.50, he figures. Pioneer is "the most under-valued stock in our universe," adds Gheit. If XTO were to buy Pioneer, it would become one of the top independents, with proven reserves of 2.1 billion barrels and a market cap of \$25 billion. Prudential Equities, "neutral" on Pioneer, nevertheless sees the stock at 53 in a year, based on strong demand for gas and falling production. Pioneer declined comment. XTO did not return calls.

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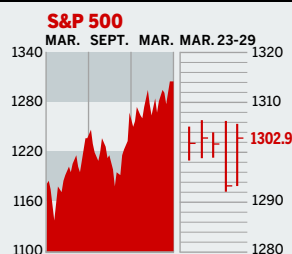
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Personal Business Figures of the Week

STOCKS



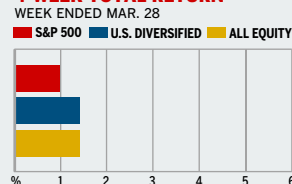
COMMENTARY

The Fed's Mar. 28 rate hike—its 15th straight—took the wind out of stocks. Although the increase had been expected, traders were dismayed that there was no hint of when the central bank's work would be done. But equities made up some ground the next day. Apple and Google sent the tech-laden NASDAQ to a five-year high, while Boeing stabilized the Dow.

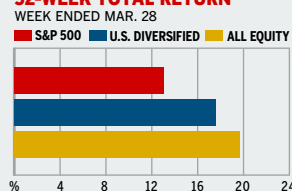
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	MAR. 29	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1302.9	-0.2	4.4	11.8
Dow Jones Industrials	11,215.7	-0.9	4.6	7.8
NASDAQ Composite	2337.8	1.5	6.0	18.4
S&P MidCap 400	791.6	1.3	7.3	22.1
S&P SmallCap 600	393.9	1.9	12.3	24.6
DJ Wilshire 5000	13,175.6	0.3	5.4	14.8

SECTORS

			% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	777.9	1.1	4.9	13.0
BW Info Tech 100**	396.1	0.8	4.1	14.7
S&P/Citigroup Growth	613.6	-0.3	2.9	9.0
S&P/Citigroup Value	686.1	0.0	6.0	14.7
S&P Energy	409.6	3.7	9.9	24.9
S&P Financials	439.9	-1.0	3.2	16.0
S&P REIT	176.9	1.8	15.6	35.3
S&P Transportation	276.4	0.2	10.6	24.9
S&P Utilities	159.2	-0.9	-0.3	10.3
GSTI Internet	194.5	2.4	-5.2	28.4
PSE Technology	875.7	0.4	4.7	21.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	MAR. 29	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1657.8	-1.3	9.7	19.9
London (FT-SE 100)	5959.2	-0.8	6.1	21.1
Paris (CAC 40)	5180.3	-0.3	9.9	26.9
Frankfurt (DAX)	5914.8	-0.3	9.4	35.9
Tokyo (NIKKEI 225)	16,938.4	2.7	5.1	46.0
Hong Kong (Hang Seng)	15,745.1	0.7	5.8	17.4
Toronto (S&P/TSX Composite)	12,190.6	1.8	8.1	29.8
Mexico City (IPC)	19,132.3	-2.4	7.5	52.1

FUNDAMENTALS

	MAR. 28	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.79%	1.78%	2.04%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.9	18.0	19.7
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1	15.7
First Call Earnings Revision*	0.44%	0.08%	0.79%

*First Call Corp.

TECHNICAL INDICATORS

	MAR. 28	WEEK AGO	READING
S&P 500 200-day average	1242.1	1239.5	Positive
Stocks above 200-day average	67.0%	66.0%	Neutral
Options: Put/call ratio	0.78	0.69	Positive
Insiders: Vickers NYSE Sell/buy ratio	5.51	5.47	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Steel	20.5	Steel	77.5
Divsfd. Metals & Mining	14.1	Oil & Gas Equip.	72.7
Oil & Gas Refining	11.1	Oil & Gas Refining	69.2
Oil & Gas Drilling	10.0	Divsfd. Metals & Mining	66.6
Constr. Materials	9.7	Constr. & Engineering	63.3

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Semiconductor Equip.	-5.0	Automobiles	-24.9
Gas Utilities	-4.9	Broadcasting	-18.1
Consumer Finance	-4.1	Home Furnishings	-14.2
Indpdt. Power & Energy	-3.6	Health-Care Facilities	-13.3
Electric Utilities	-3.2	Diversified Chemicals	-12.7

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Natural Resources	4.6	Latin America	74.7
Real Estate	3.8	Precious Metals	59.4
Precious Metals	3.6	Diversified Emerg. Mkts.	47.9
Communications	3.1	Natural Resources	40.9
LAGGARDS		LAGGARDS	
Latin America	-4.8	Domestic Hybrid	10.1
Utilities	-1.6	Large-cap Blend	13.3
Health	-1.0	Miscellaneous	13.3
Diversified Emerg. Mkts.	-0.9	Large-cap Value	13.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
American Heritage	12.5	ProFunds Ultra Japan Inv.	102.2
Van Wagoner Sm. Cap. Gr.	10.1	ING Russia A	88.1
U.S. Global Invs. Gold	9.7	Midas	87.7
U.S. Gbl. Invs. Prc. Mnls.	9.3	U.S. Global Invs. Gold	86.3
LAGGARDS		LAGGARDS	
Ameritor Investment	-16.7	Ameritor Investment	-68.8
iShares MSCI Brazil Idx.	-9.0	Potomac Sm. Cap/Sh. Inv.	-37.4
Allianz RCM Biotech. D	-7.0	ProFds. USh. Sm. Cap Inv.	-36.1
T. Rowe Price Emg. Europe	-5.5	American Heritage Grth.	-33.3

INTEREST RATES

KEY RATES

	MAR. 29	WEEK AGO	YEAR AGO
Money Market Funds	4.20%	4.09%	2.26%
90-Day Treasury Bills	4.62	4.68	2.83
2-Year Treasury Notes	4.80	4.74	3.84
10-Year Treasury Notes	4.81	4.70	4.58
30-Year Treasury Bonds	4.84	4.72	4.84
30-Year Fixed Mortgage †	6.29	6.25	6.06

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.96%	4.37%
Taxable Equivalent	5.66	6.24
Insured Revenue Bonds	4.01	4.54
Taxable Equivalent	5.73	6.49

THE WEEK AHEAD

VEHICLE SALES Monday, Apr. 3

» March sales of light vehicles most likely posted a narrow gain, to an annualized rate of 16.8 million, according to WardsAuto.com. In February sales slowed to a pace of 16.6 million units.

PURCHASING MANAGERS' INDEX

Monday, Apr. 3, 10 a.m. EDT

» The Institute for Supply Management's March factory activity index is forecast to have come in at 57%. That's the median

forecast among economists surveyed by Action Economics. In February the index rose to 56.7%.

CONSTRUCTION SPENDING

Monday, Apr. 3, 10 a.m. EDT

» Building outlays probably improved by 0.4% in February, following a 0.2% increase during January.

EMPLOYMENT Friday, Apr. 7, 8:30 a.m. EDT » Nonfarm payrolls in March most likely rose by 200,000 workers, after the

economy added 243,000 jobs in February. The unemployment rate is expected to remain at 4.8%. Average weekly wages probably rose 0.2%, after growing 0.3% in the prior month.

INSTALLMENT CREDIT Friday,

Apr. 7, 3 p.m. EDT

» Consumers most likely assumed an additional \$3.9 billion of debt in February, the same amount by which installment credit grew during January.

The *BusinessWeek* production index was virtually unchanged at 269.2 for the week ended Mar. 18, up 12.7% from a year ago. Before calculation of the four-week moving average, the index held at 269.1.

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For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

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The Shortsighted Solution

THE DISPOSABLE AMERICAN Layoffs and Their Consequences

By Louis Uchitelle; Knopf; 283pp; \$25.95

Some economists call it the hedonic treadmill: The way many Americans work (all the time) and live (in an arms race for status) conspires against the happiness they say they crave. We're the richest, most powerful country in the world. But an increasing amount of hard data shows that as our ability to own

homes and cars and TVs has increased, so have our rates of addiction, depression, and economic inequality. These findings are causing some economists and policymakers, including *New York Times* economics reporter Louis Uchitelle, to raise questions about whether we've sacrificed too much for growth. After all, if we're not achieving the greatest happiness for the greatest number, why, asks Uchitelle in his important new book, *The Disposable American*, does the pursuit of growth still rule economic ideology?

Fundamentally, Uchitelle's book is about what he views as the folly of the modern layoff—one of the inevitable results of an economy designed for nonstop expansion. Uchitelle draws upon mounds of research to show that slashing staff in the name of growth does not, in the long run, lead to better stock performance. Yet CEOs, their thinking warped by Wall Street-induced short-term-itis, continue to hack away. The more anorexic their payrolls, the more obese the CEOs' pay packages. This culture, in which employees are treated as if they have sell-by dates, Uchitelle says, has huge, oft-ignored costs, and he rails against the idea that there's no alternative to reduction in forces. He describes the problems, especially the psychological fallout, so well that one yearns for more innovative solutions. But his prescriptions differ little from those backed by progressives since at least the 1930s. Still, the logic with which he lays waste to commonly accepted layoff rationalizations is airtight.

Rationalization No. 1: Layoffs save money. What that equation misses, says Uchitelle, are hidden costs that include severance, potential lawsuits from aggrieved workers, loss of institutional memory and trust in management, a shortage of staff when the economy rebounds, rehiring expenses, and a culture of survivors who are risk-averse, paranoid, and alienated. Contrast that with the evidence Uchitelle marshals to argue for a no-layoff payoff: fierce loyalty, higher productivity, and superior innovation at such companies as Southwest Airlines and Harley-Davidson.

Rationalization No. 2: So what if the labor market is a game of musical chairs where workers routinely get bounced? There are lots of good jobs, at least for the college-educated. Uchitelle's opinion, shared by a growing group of economists, is that, to the contrary, there just aren't enough well-paying jobs with decent benefits to meet demand. Today's low jobless figures miss all the people who are "bought out" but really exiled, who are "free agents" but really traded back and forth in the global discount labor bazaar. One of *The Disposable American's* most poignant anecdotes involves a 47-year-old executive who, after 25 years with Procter & Gamble, loses her \$150,000 a year job in a buyout. Then, when one of the

cheaper young staffers hired to replace her falters, she is rehired as a "consultant"—at \$75 per hour for three to five hours a week. There's also the laid-off sixtysomething who strenuously works his alumni network only to net zero job offers, even though he has degrees from Harvard and Wharton. His depressing conclusion? His education hurt him by setting him up for expectations that he can never fulfill.

Many say that, in the end, layoffs will bring about a reenergized, dynamic U.S. economy, one that will eventually lead to another era of equilibrium. In contrast, Uchitelle argues that the rampant income volatility produced by a layoff-happy business culture is creating a society of downwardly mobile, insecure workers. The problem is that today's social infrastructure was built for the Company Man, not for the you're-on-your-own free agent. In

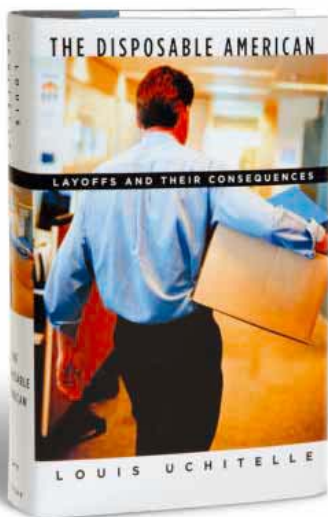
this great risk shift, burdens once shared within society are being transferred onto employees' shoulders.

That's why Uchitelle argues that America needs a new social safety net. His fixes include a passel of liberal reforms: a more progressive income tax, a government jobs program, an increase in the minimum wage, laws requiring severance packages, and stronger labor regulations. He knows that

Layoff mania is creating a society of insecure, downwardly mobile people

many will balk at these shopworn ideas. But instead of relying on logic to make his case, he appeals to Americans' sense of well-being: People who live in societies where these elements are a given, he correctly reports, say that they are more content. Similar results are reported by those who feel their work is stable. With such realities, Uchitelle says, layoffs should be the last place CEOs turn—not the first. ■

—By Michelle Conlin



The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST	PAPERBACK BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST
1	THE WORLD IS FLAT Thomas L. Friedman (Farrar, Straus & Giroux • \$27.50) <i>Globalization is great—sort of, says a columnist from The New York Times.</i>	1	10	1	GOOD TO GREAT AND THE SOCIAL SECTORS Jim Collins (Collins • \$11.95) <i>How noncorporate organizations can excel.</i>	15	3
2	FREAKONOMICS Steven D. Levitt, Stephen J. Dubner (Morrow • \$25.95) <i>Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.</i>	2	11	2	GETTING THINGS DONE David Allen (Penguin • \$15) <i>Organizing your office and learning how to manage your time.</i>	1	23
3	BLINK Malcolm Gladwell (Little, Brown • \$25.95) <i>Why snap judgments deserve careful consideration.</i>	3	14	3	COLLAPSE Jared Diamond (Penguin • \$17) <i>From Easter Island to Central America, why civilizations fall apart.</i>	—	1
4	JIM CRAMER'S REAL MONEY James J. Cramer (Simon & Schuster • \$26) <i>Trading recommendations from the CNBC commentator.</i>	6	11	4	THE AUTOMATIC MILLIONAIRE David Bach (Broadway • \$12.95) <i>How you can put your investment program on autopilot.</i>	2	2
5	THE LITTLE BOOK THAT BEATS THE MARKET Joel Greenblatt (Wiley • \$19.95) <i>The basics of "value investing."</i>	5	3	5	J.K. LASSER'S YOUR INCOME TAX 2006 The J.K. Lasser Institute (Wiley • \$16.95) <i>Sharpen your pencils, and...</i>	3	3
6	THE NUMBER Lee Eisenberg (Free Press • \$26) <i>A meditation on retirement and second acts, by the former editor-in-chief of Esquire.</i>	4	2	6	CONSPIRACY OF FOOLS Kurt Eichenwald (Broadway • \$16.95) <i>Inside Enron's crumbling house of cards, by an investigative reporter from The New York Times.</i>	6	2
7	THE LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Bard Press • \$19.95) <i>A columnist on why people buy.</i>	7	18	7	THE ERNST & YOUNG TAX GUIDE 2006 Ernst & Young, LLP (CDS Books • \$16.95) <i>...get out the calculator.</i>	4	3
8	THE TOTAL MONEY MAKEOVER Dave Ramsey (Thomas Nelson • \$24.99) <i>Getting rid of debt and building up your rainy-day reserves.</i>	9	15	8	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed Press • \$17.95) <i>The 2006 edition of the enduring job-search bible.</i>	5	3
9	THE WAL-MART EFFECT Charles Fishman (Penguin Press • \$25.95) <i>The retailer's single-minded focus on price-cutting is good for some, disastrous for others.</i>	—	1	9	THE WALL STREET JOURNAL COMPLETE MONEY & INVESTING GUIDEBOOK Dave Kansas (Three Rivers Press • \$14.95) <i>From balance sheets to a business vocabulary.</i>	7	2
10	SECRETS OF THE MILLIONAIRE MIND T. Harv Eker (HarperBusiness • \$19.95) <i>Shape your financial destiny.</i>	—	11	10	PAY IT DOWN! Jean Chatzky (Penguin • \$12.95) <i>The Today Show's financial editor on dumping your debts</i>	—	1
11	THE FRED FACTOR Mark Sanborn (Currency/Doubleday • \$14.95) <i>The mailman's philosophy of work and life.</i>	13	15	11	FIND IT, FIX IT, FLIP IT! Michael Corbett (Penguin • \$15) <i>Profiting from real estate, by a television-show host.</i>	—	1
12	THE ONE MINUTE MANAGER Kenneth Blanchard, PhD, Spencer Johnson, M.D. (Morrow • \$19.95) <i>Three management techniques, conveyed in brief story form.</i>	—	11	12	TOTAL MONEY MAKEOVER WORKBOOK Dave Ramsey (Thomas Nelson • \$17.99) <i>Give your finances a workout and whip them into shape.</i>	9	14
13	THE MILLIONAIRE MAKER Loral Langemeier (McGraw-Hill • \$24.95) <i>Bet the ranch, says this single mom and seminar leader.</i>	—	1	13	RICH DAD'S BEFORE YOU QUIT YOUR JOB Robert T. Kiyosaki with Sharon L. Lechter, CPA (Warner • \$16.95) <i>Starting your own business.</i>	—	4
14	WINNING Jack Welch with Suzy Welch (HarperBusiness • \$27.95) <i>How to succeed within a company, against your competition, and over the course of a career.</i>	10	11	14	THINK AND GROW RICH Napoleon Hill (Ballantine • \$7.99) <i>Willpower and a positive attitude are the keys to achieving wealth.</i>	—	11
15	THE COMING ECONOMIC COLLAPSE Stephen Leeb, PhD, with Glen Strathy (Warner • \$24.95) <i>You can get rich from the coming oil shortfall.</i>	—	1	15	INVESTING FOR DUMMIES Eric Tyson, MBA (Wiley • \$21.99) <i>The fundamentals of real estate, the stock market, small business, and so forth.</i>	12	12

LONG-RUNNING BEST-SELLERS

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FIRST, BREAK ALL THE RULES Marcus Buckingham, Curt Coffman (Simon & Schuster • \$27)

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THE TIPPING POINT Malcolm Gladwell (Back Bay • \$14.95)

RICH DAD, POOR DAD Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$16.95)

THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Free Press • \$15)

THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16)

GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$15)

THE RICHEST MAN IN BABYLON George S. Clason (Signet • \$6.99)

RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95)

SMART WOMEN FINISH RICH David Bach (Broadway • \$14.95)

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in February.

Reviews and more are available on AOL (Keyword: BW) or www.businessweek.com

April 10, 2006 | BusinessWeek | 111



Ideas **The Welch Way**

BY JACK AND SUZY WELCH

Paying Big-Time for Failure

What do you think about the obscene severance packages being handed out to CEOs who have basically failed on the job? As a (small) stockholder and a middle manager who busts his butt for five figures, that drives me crazy.

—Anonymous, Miami

You're not alone, but just make sure you aim your anger in the right direction—and that might not be at the CEOs getting the huge payouts. All they did was say: "Yes, thank you," when offered a big package. Greedy? Maybe. But more often, they are simply the beneficiaries of a common and disturbing dynamic that starts in the boardroom.

Which brings us to the real culprits here, the company directors. They're behind many severance pay debates for one main reason: They messed up succession planning.

Why does succession planning have so much to do with severance pay? Because many of the "obscene" payout deals that bother you so much weren't created when the errant CEO was fired. They were designed long before, when the new boss was hired from the outside because the board failed, over several years, to develop a pool of internal talent.

Not that internally promoted CEOs come cheap. The typical insider will get a substantial pay increase, hefty rewards tied to performance, plenty of new perks, and a bigger office. But the deal gets much richer when a white knight has to be enticed to gallop in and save the company from itself. These saviors on horseback get everything an insider gets, plus the guarantee of a big consolation prize even if they blow it. And that last part is usually why the deal gets sealed. Without back-end protection, no outsider would touch most of these risky positions.

Not all severance messes are related to outsider CEOs, of course. Sometimes insider CEOs fail and get sent on their way with more money than they appear to deserve. That can be galling, too, but the dynamic we're talking about is different. It starts when a board needs a new CEO and, looking inward, realizes: "Oops! We forgot to plan for that." The directors then call in a headhunter, whose lust for a successful placement is second only to the board's level of panic. The dynamic is complete when a seemingly perfect candidate is located—usually in a wonderful, secure job that he or she has

no intention of leaving. Unless, of course, the deal is right.

Case in point: Hewlett-Packard. Back in 1999, when the board decided to change CEOs, the lack of internal candidates launched headhunters into a national search. Soon enough they found Carly Fiorina, successfully toiling away at Lucent Technologies. Amid great fanfare, she was pried away from her comfortable position with, needless to say, an offer she couldn't refuse.

But Carly's six-year tenure at HP was fraught with board dissension. So you would think that when she was fired, her farewell gift would be modest. At about \$40 million, it wasn't—sparking widespread criticism, much of it aimed at Carly. But what about HP's board? Without doubt, it negotiated the severance payout, and it did so as Carly was prancing in with trumpets blaring, not as the door was slamming behind her.

The HP case is hardly unique, although sometimes the endings are happier. Take Ed Breen and Tyco. In 2002, Tyco was hit by a disastrous accounting scandal, and its CEO was removed. Again, the board turned to headhunters, who quickly set their sights on Ed, a respected executive at Motorola. But Ed wasn't going to quit a thriving career at an unsullied company to clean up the chaos at Tyco for a standard-issue deal. No wonder the board had to back up a Brink's truck to unload a new compensation package at his doorstep. Fortunately, Ed is doing a good job at Tyco, so the terms of his severance package are a moot point.

Look, we agree that severance packages can be obscene. But unfortunately, this problem is probably going to get worse. The reason: Sarbanes-Oxley has driven scores of boards into a state of frenzied micromanagement. Too many of them are now more concerned with accounting minutiae than with people development, including succession planning. What a shame. Boards have only one job more important than developing internal candidates: coaching and supporting the current CEO. Boards can't do the work of management. They can only make sure the right management is in place, now and in the future.

So we're with you on this one and don't blame you for wanting to scream. The big severance packages awarded to failed leaders make you question the whole capitalistic system. But should you ever decide to really let it rip, just make sure, if the CEO was an outside recruit, that you aim your invective not at the easy target, but at the right one. ■

*Jack and Suzy Welch are co-authors of the best-seller *Winning* (HarperCollins 2005). They look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com.*

“If you see money in your code, you want to protect it. If you don’t, then you want it liberated.”

— Dana Blankenhorn, ZDNet Open Source Blog

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IdeasOutsideShot

BY TOM DASCHLE

Health Reform: Good Business

The biggest frustration during my 26 years in Congress was our failure to address the health cost crisis. Ideological differences certainly made progress difficult. But more destructive were the mixed messages coming from the business community. Even as business leaders at home insisted that the current system was unsustainable, their lobbyists in Washington

often blocked change. That gap must be bridged because Congress can make our health system more efficient and equitable only if the power of business is brought to bear.

You need only look at the auto industry for proof that our health-care system is broken. Ford and General Motors pay nearly \$1,500 in health-care costs for each vehicle they produce, while BMW pays \$450 per car in Germany and Honda \$150 in Japan. Unfortunately, every American company faces a similar burden. The Bush Administration reported that U.S. health spending hit a record 16% of gross domestic product in 2004, when businesses spent \$448.3 billion on health benefits.

Detroit's continuing market-share declines show how these costs hurt competitiveness. But hefty health-care bills also affect jobs and profits. One in five employers expects to slow hiring in 2006 because of health costs. And health costs are likely to exceed profits at the largest corporations by 2008, according to a McKinsey & Co. analysis.

Relief requires major reform in the way we buy and finance health insurance, making care accessible and affordable to all. But reform will come only when business leaders recognize they have the most to lose from the current system and the most to gain from broad reforms. Unfortunately, so far we have seen a failure of leadership in both our nation's capital and its boardrooms in crafting a solution.

Beltway-based business lobbying groups have fought major reform based on two claims. The first is that government cannot do as well as private industry leaders in addressing the crisis. True, some companies succeed in providing workers with high-quality care at a reasonable price. But that's the exception. More often, small and rural businesses are unable to negotiate reasonable insurance rates, while large companies with aging, less healthy workers face ever-rising premiums. Meanwhile, a handful of large insurers and hospital systems have gained control of the market, reducing competition. The bottom line: Most employers face

structural challenges that don't permit them to contain costs.

The second claim is that the "cure will be worse than the disease" because Washington will increase regulation and costs to businesses. This does occasionally occur, but it will almost certainly happen if businesses sit on the sidelines. Indeed, by spending nearly half a trillion dollars a year on health benefits, business has earned a seat at the table to fix the system—it just needs to take it. Here are three ways it can:

First, business can help banish the myths that block reform. Too many Americans believe they have the best health system on the globe. But the World Health Organization actually ranks the U.S. 37th in world health system

performance. No smart investor would accept such disappointing performance.

Second, business leaders can bring real-world experience in areas like disease prevention, achieving economies of scale, and expanding coverage to boost productivity and reduce costs. Such proven solutions, rather than President George W. Bush's "consumer-directed health care," should be the basis for real reform.

Third, business leaders themselves can demand that Washington make health reform a top priority. Despite their own enormous health costs, leading corporations outsource to Washington-based business associations the job of representing them in this area. These groups advocate little real change, since they must find

the lowest common denominator among their members. Yet small businesses have different priorities than large businesses, as do those in different industries and regions. So those who benefit from the status quo, even if in the minority, tend to prevail.

That must change. American businesses, like American families, are suffering from today's health cost crisis. So it is time for business leaders, in the best interest of employees, shareholders, and the country, to pave the way for action. ■

Tom Daschle, former *Senate Minority Leader (D-S.D.)*, is a *Distinguished Senior Fellow at the Center for American Progress* and special adviser at *Alston & Bird LLP*.

**So far,
corporate
lobbyists
have fought
major reform
based on two
false claims**

Views expressed in *Outside Shot* are solely those of contributors.



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